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THE INSPECTORS GENERAL REPORT ON THE EXPORT-CONTROL PROCESS FOR DUAL-USE AND MUNITIONS LIST COMMODITIES

HEARING

BEFORE THE

COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE

ONE HUNDRED SIXTH CONGRESS

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WEDNESDAY, JUNE 23, 1999

U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The Committee met, pursuant to notice, at 10:06 a.m., in room SD–342, Dirksen Senate Office Building, Hon. Fred Thompson, Chairman of the Committee, presiding.

Present: Senators Thompson, Collins, Specter, Lieberman, and Akaka.

OPENING STATEMENT OF CHAIRMAN THOMPSON

Chairman THOMPSON. Good morning. Let us come to order, please.

During the Cold War, export control rules were a major plank in our national security strategy. Things have changed a lot since then. Back in those days, we elevated it to such importance that we had an international regime called COCOM, where we got together with other countries to try to make sure that we all kept the wrong kinds of materials out of the wrong hands.

Since the Cold War, we have taken a different attitude. We have relaxed our controls considerably as a matter of national policy. There are far fewer items that even require a license, and that is reflected in the numbers, some of which we will see today.

COCOM is gone now. It has been replaced by other regimes that are not nearly as stringent and that basically depend upon the voluntary compliance of the members nation. So that has been going on for some time now.

Recently, our attention has been grabbed again and we have been hearing things at an ever-increasing rate that should cause us all great concern with regard to matters of national security and whether or not we are losing items, elements, information, and technology that will turn out to be dangerous to this country. We certainly are very much aware of the espionage issues that we have seen.

But while that is a back-door problem, we have also got a substantial front-door problem, and that has to do with our own policies and the way that we treat our exports in this country. While we have been relaxing our standards, we know that we are targeted in this country. Our technology is targeted. As Senator Rudman has pointed out, not only do we do the Nation's best work in

these laboratories of ours, but we do world class work in terms of our technology there. They are certainly targeted.

The Cox report has pointed out that with regard to satellite technology, supercomputers, and machine tools, all these things, we are targeted. People want this stuff, and if it is proper and legitimate, then we want them to have it. We are interested in sales. But I think there is a growing concern, and I think properly so in this country, that we have tilted the balance too far in favor of sales and away from national security at a time when we should know better. If we did not know better even a few months ago, we know better now.

We know that some of this dual-use technology is being diverted. We put these conditions on these licenses and say you cannot do this and cannot do that and then people proceed to do this and do that and we have few ways of checking up on them. Indeed, the ways that we do have, we do not utilize.

We stumble across things like the McDonnell Douglas machine tool case a while back, where the Chinese said that they were buying all these tools for commercial airline purposes. The only problem was, it was for military purposes, as we only accidentally found out.

We know, by the same token, that many of these countries that we are dealing with proliferate weapons as a matter of policy. The world's greatest proliferators, with whom we are trading, send weapons of mass destruction, biological and chemical capabilities, to these rogue nations. Yet we expect them to honor their word concerning what they are going to do with the products that we send them. I think we have been very naive and I think that what has been going on recently surely will be a wake-up call to us.

In August 1998, I wrote to the Inspectors General at six Federal agencies, the Departments of Commerce, Defense, State, Treasury, and Energy, and the Central Intelligence Agency. I requested that they undertake a review of U.S. export control policy and report their findings to this Committee. Several of these IGs had undertaken a review of the export-control processes in 1993, but in the world of export control rules, that was a very long time ago. The statute governing export controls, the Export Administration Act, lapsed in 1994 and has been continued and amended since then only through Executive Orders.

I requested that the IGs give us an assessment of how the post-Cold War export control system works and how it does not. The interagency report that we have before us today is the fruit of their labors, and I think it is particularly timely. It is no less important today than ever before that we strike a sensible balance between promoting commerce and protecting national security.

The Senate is presently working on the reauthorization of the Export Administration Act and it is our hope that this IG review will help inform and educate members on the complexities of the major export control system, thus equipping us to meet the challenges of adapting the Export Administration Act to today's world of rapidly-changing technologies and new security threats.

This is the second hearing the Governmental Affairs Committee has had as a result of the IG's export control review. We held a hearing on June 10 with the Department of Energy Inspector Gen-

eral that helped illuminate Energy's role in the export-control process and highlighted the problem of uncontrolled "deemed exports" which occur when foreign nationals visiting DOE weapons labs come into contact with sensitive dual-use and munitions technologies. We will have a chance to explore that a little bit further today.

I want to thank all of you for your hard work in this area over a long period of time. I think that we are going to learn some important things today. Many of us have had a chance to go through the reports that you have filed, and they speak for themselves. Hopefully, we can use this forum to highlight and elucidate the points you make in the reports.

I think that what we are going to see is that these matters are becoming more and more complex, and licensing officers are required to do more and more all the time. But we are giving them less time in which to do it. We are giving them practically no formal training. We are not making any assessment of the cumulative effect of this technology that we are giving to these various nations. We examine this little hole in the dike and say, that is no big problem, and nobody has any idea how many holes there are in the dike.

We have got a process where, by law, the Department of Commerce, primarily concerned with selling things, is given responsibility in this area. They are supposed to bring in, when appropriate, these other agencies to take a look. The President's Executive Order allows any agency now to take a look at what they feel like they ought to take a look at.

But it does not take a rocket scientist, which is perhaps an appropriate reference, to come away with the notion that this process is designed basically for Commerce to get its way, and that this is a process that is designed to basically discourage appeal. If you are an agency out there and have a problem with a proposed export license, you do not have time, for one thing, to do much with it. We will examine some of these things today.

CIA is supposed to do end-user checks within 9 days, for example. That is ridiculous. I do not care what your analysis is on that. On its face, knowing what we know, with the problems we have—we are dealing with China and we are dealing with all these other countries, India, former Soviet Bloc countries—the CIA is given 9 days to check on the end-user situation and to what they are supposed to be doing with that. That is just one example.

We place conditions on these licenses that look real good on paper. They are all there, right there. They are conditions. We are not going to let them do this, we are not going to let them do that. But then we do not follow up to see whether or not they are doing it anyway. There are time constraints, pressures to get the stuff out the door and get on to the next one, and in some cases, just clear violations of the law.

The law requires, for example, that there be training programs for licensing officers. Statutory law requires that. The Department of Defense, I know, and I assume these other agencies, also have regulations requiring that, they set this up. I am sure that, many times, the representatives of these departments come up here and

say, we have got these programs, requirements and so forth, but, in fact, there is no formal training that I can detect.

They say it is on-the-job training, which is basically what you call it when you do not have a training program. When you are not doing any training, that is what you call it, which is fine if you are a plumber's helper, but it is not fine if you are an airline pilot, and we have got to decide whether or not we are dealing with stuff here that more likely relates to one or the other.

The Department of Defense is supposed to assess defense-related export licenses. The Department of Defense is also supposed to analyze the cumulative effect of what we are doing here. You would think somebody might be doing that. The Department of Defense is supposed to be doing it. They do not do it. Nobody does it. They just do not do it.

That reminds me of some testimony we heard yesterday from Senator Rudman when he was talking about the Department of Energy. He was talking about the culture at the Department of Energy, the problems that they have—arrogant, dysfunctional, and not even paying any attention to the President of the United States. When he puts down an Executive Order, it takes forever to get it done. You get a few people scurrying around at the top, but down within the bowels of the organization, they think, "we were here when you got here, we are going to be here when you are gone." What makes us think that is just applicable to the Department of Energy?

So I think your assessment seems to be that the railroad is running on time, there is no real indication that there is any breakdown, apparently, it is working, and so on. But we do not know whether it is working or not. All we know are these things that pop up every once in a while that show that we have serious diversion problems, we have got serious end-user problems, and we have got serious espionage problems. What we need to concentrate on is not necessarily trying to get to the bottom line of whether or not you can prove that our lunch has been stolen in any particular instance, which is almost impossible to prove anyway. We have got to look at the procedures that we have got and whether or not they are decent procedures and whether or not they are being followed and carried out. I think that is what you have done here.

Thank you for your work and I look forward to getting into it with you. Senator Lieberman.

OPENING STATEMENT OF SENATOR LIEBERMAN

Senator LIEBERMAN. Thanks, Mr. Chairman. Thanks to the IGs. As you have indicated, Mr. Chairman, for the second time in recent weeks, we will be taking up an issue this morning of vital interest, which is the export-control process. In many ways, it is the other expression of the concern that has generated a lot of controversy and attention on the Hill right now, and that is the extent to which we are maintaining security at our national laboratories. The export-control process deals with some of the same questions through a different window.

I do want to say that I am again very impressed by the reports put together by the IGs. This critical area of national concern has been given in these reports the kind of careful attention that it

merits, and I truly thank the IGs for that. Their work will be particularly helpful in light of the imminent debate over reenactment of the Export Administration Act.

An export-control process that works well is critical both to our national security and to our national economic well-being. These reports, more than any other material that I have seen on the subject, offer not only insight into the way the system works now, but also some very helpful guidance on how to make the system work better in the future.

I was very heartened to read that, on the whole, the IGs conclude that the current control process is working pretty well, and, in fact, has, "greatly improved" since the 1993 IG report. I was specifically reassured to note that the IGs found no evidence of political pressure on licensing officers to change recommendations on applications.

Nevertheless, the reports do point out that significant improvements are still needed. Some of these matters, such as better training and records management, fall to the individual agencies to address. Others may require interagency cooperation. In fact, they do require interagency cooperation.

For example, I was surprised to learn of the absence of an overall mechanism to address the question of the cumulative effect of multiple exports to a particular country. Various licensing officers at different places in our government, each focusing on the sale of one commodity, if I can call it that, at a time, might consider each purchase to be benign, but if all the acquisitions were considered together, they might well paint a more ominous picture of a country or purchaser seeking to obtain components necessary to design, for instance, a weapon of mass destruction.

So drawing the agencies together to consider cross-cutting issues like this should be one of the most important outcomes of this effort. We should strongly encourage interagency cooperation to look at this question of cumulative analysis.

We in Congress also need to take steps to strengthen the export-control process. All of the IGs have endorsed legislative action to revive the Export Administration Act, which, hopefully, will be coming up for consideration this session, and this, too, is an area where I think we will want to explore and respond to the problem of cumulative effects.

On the whole, I am encouraged that the relevant agencies seem to agree with the recommendations put forth by these IG reports and are apparently working to implement responses. However, in some cases, progress may be hampered by resource constraints.

Commerce, for example, is currently using an export control database that was designed in 1984. The Department is seeking funding, $2.5 million, which in a budget the size that we have is really not much at all, to create a state-of-the-art system that would be compatible with the other agencies and, I think, would pay for itself, certainly in increased security, many times over.

Finally, Mr. Chairman, with the agencies generally expressing support for the IG recommendations, I hope that our Committee will consider holding a follow-up hearing to take stock of their progress in implementing these recommendations several months

down the road so that our continued oversight here will, hopefully, help keep the momentum of improvement and reform going.

But the bottom line is I thank the IGs. I thank you for requesting these reports. I thank the IGs for their very carefully considered and constructive responses and I look forward to their testimony this morning.

Chairman THOMPSON. Thank you very much.

I would ask that each of you give a short summary of what we are dealing with here. We will have ample opportunity for everyone to express their views. Mr. Mancuso, I think you might have an overview of the entire situation yourself, so we will just start with you.

TESTIMONY OF DONALD MANCUSO,[1] ACTING INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

Mr. MANCUSO. Mr. Chairman and Members of the Committee, I appreciate the opportunity to discuss the Federal Government's export licensing process for dual-use commodities and munitions. In response to the Chairman's letter of August 26, 1998,[2] Inspector General teams from the Departments of Commerce, Defense, Energy, State, Treasury, and the CIA conducted an extensive review. Our efforts were coordinated by a working group, thus avoiding duplication and enabling us to track individual export license application cases across agency lines and to address interagency issues. The results are contained in an interagency report and six individual agency reports.

I have Evelyn Klemstine with me today, who is on my staff and who acted as the facilitator for the team and who will also be available to answer any questions.

Inasmuch as my office assembled and published the interagency report, I will begin my testimony by summarizing its main points in this joint endeavor.

Dual-use commodities are goods and technologies with both military and commercial applications. The dual-use export licensing process is governed by the Export Administration Act of 1979, as amended. Although the Act expired in 1994, its provisions are continued by Executive Order 12981, under the authority of the International Emergency Economics Powers Act. Munitions exports are controlled under the provisions of the Arms Export Control Act.

The dual-use export licensing process is managed and enforced by the Department of Commerce, although the Department of State manages munitions export licensing. The Departments of Defense and Energy review the applications and make recommendations to Commerce and State. The Central Intelligence Agency and Customs Service provide relevant information to Commerce and State, while Customs also enforces licensing agreements for all export shipments except outbound mail, which is handled by the Postal Service. In 1998, the Department of Commerce received 10,696 dual-use export license applications, while State received 44,212 munitions export license applications.

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[1] The prepared statement of Mr. Mancuso appears in the Appendix on page 50.
[2] The letter referred to appears in the Appendix on page 47.

The overall objective of the interagency review was to determine whether current practices and procedures are consistent with established national security and foreign policy objectives. To accomplish this objective, we reviewed various random samples of licensing cases to determine if prescribed processing procedures were followed within each agency and in multi-agency groups.

To a considerable extent, our June 1999 report is an update of a similar report that was issued jointly by Commerce, Defense, Energy, and State IGs in 1993. The previous report covered the pertinent issues under seven headings, and this current report is structured along similar lines.

The first area relates to the adequacy of export control statutes and Executive Orders. We concluded that, in general, the Arms Export Control Act and the provisions of the Export Administration Act, as clarified by Executive Order 12981, are consistent and unambiguous. However, the Commerce and Defense IG teams stressed that the dual-use licensing process would be best served if the Export Administration Act were reenacted rather than continue to operate under a patchwork of laws and Executive Orders.

Executive Order 12981 is generally consistent with the Export Administration Act. However, the order requires modification to reflect the merger of the Arms Control and Disarmament Agency with the Department of State and to clarify representation at the Advisory Committee on Export Policy. In addition, policy and regulations regarding the export licensing requirements for items and information deemed to be exports needs clarification and the exporter appeals process should be formalized.

The second area pertains to procedures used in the export license review processes. Commerce, Defense, Energy, and State IG teams concluded that processes for the referral of dual-use license applications and interagency dispute resolution were adequate. Officials from those Departments were generally satisfied with the 30-day limit for agency reviews under the Executive Order. However, not every agency could meet that limit. Several defense components and the CIA indicated they would benefit from additional time to review dual-use license applications.

Defense and State IG teams were satisfied with the referral of munitions license cases for review. However, the Commerce IG believed that the inclusion of the Department of Commerce in the munitions case referral process should be considered. The Commerce commodity classification process could also benefit from additional input on munitions-related items from the Departments of Defense and State. Also, Energy officials believe that a more formal review process for munitions was needed, as the officials there were unclear on their role in the current process.

The third area pertains to the cumulative effect of multiple exports to individual foreign countries. The U.S. Government lacks an overall mechanism of conducting cumulative effect analysis. However, some of the agencies involved in the licensing process perform limited cumulative effect analysis, but to varying degrees. Commerce, Defense, Energy, and State IG teams concluded that additional effect analysis would benefit the license application review process.

The fourth area relates to information management. Commerce, Defense, and State teams questioned the adequacy of automated information systems their Departments use to support license applications reviews. Specifically, there were shortfalls in data quality, systems interface, and modernization efforts. The audit trails provided by most of the respective export licensing automated databases was adequate, but Defense procedures did not ensure that final Defense positions were accurately recorded. The CIA reported unsatisfactory documentation of end-user checks on munitions license applications.

The fifth set of issues concern guidance, training, and undue pressure on case analysis. A review indicated that Defense, Energy, and State licensing officials had adequate guidance to perform their mission. However, the Department of Commerce licensing officers and CIA licensing analysts could benefit from additional guidance. On-the-job training was the primary training available at Commerce, Defense, Energy, and State for licensing officers. The Commerce, Defense, and State teams identified a need for standardized training in their agencies. With very few exceptions, Commerce and Defense licensing officers reported they were not pressured to change recommendations on license applications. No Energy or State licensing officials indicated that they had been pressured.

The sixth area regards monitoring and compliance and end-use checks. Commerce did not adequate monitor exports from exporters on shipments made against licenses and the Department of State's end-use checking program could be improved. Commerce and State still use foreign nationals to conduct an unknown number of end-use checks. The Commerce IG team found that most end-use checks were being conducted by U.S. and foreign commercial service officers or Commerce enforcement agents. The State IG team concluded it may be appropriate to use foreign nationals to do the checks under certain conditions.

The seventh area pertains to export controls enforcement. The Treasury IG team determined that although Customs Service export enforcement efforts have produced results, the Customs Service is hindered by current statutory and regulatory reporting provisions for exporters and carriers. The Treasury IG team also identified classified operational weaknesses in Customs export enforcement efforts. The IG teams made specific recommendations relevant to their own agencies. Those recommendations and management comments are included in the separate reports issued by each office.

Now, I would like to change focus from the interagency report to the report issued by my office. Again, I emphasize that our objective was to review the export licensing process and not to assess the appropriateness of individual license applications. To summarize the results of the Defense team's review, I will address each of the 14 issues in the Chairman's letter, as posed in his 1998 letter. The full text of each issue in the letter is posted to my right on the board.

Issue 1 asked that we examine relevant legislative authority. We found that the general nature of the Export Administration Act and the Arms Export Control Act creates a broad framework, but

we found no inconsistencies or ambiguities in either law. We concluded that the dual-use licensing process would be best served through the reenactment of the Export Administration Act.

Issue 2 requested our review of the Executive Order. We found that the Executive Order, as implemented, is generally consistent with the objectives of the Export Administration Act, but inasmuch as the Executive Order decreased from 40 to 30 days the time that the Department has to review license applications, this has resulted in a potential inability to locate information necessary to inject into the review process.

Issue 3 questioned whether Commerce is properly referring export license applications out for review by other agencies. Our review indicated that Defense officials expressed general satisfaction with referrals from Commerce but disagreed with Commerce's decision not to refer 5 of 60 sampled applications. They also expressed concern that Commerce referred too few commodity classification requests for review. As a result, in some cases, decisions on licensing applications with national security implications were made without the benefit of Defense Department input.

Issue 4 concerns the interagency dispute resolution process. With one exception, we found that the interagency escalation process provides Defense a meaningful opportunity to appeal disputed dual-use license applications, although the outcome of the process often favors the Commerce position. Defense elected not to escalate some disputed dual-use applications after weighing such considerations as the substance of the case, the viewpoints expressed by Department principals, and the likelihood of prevailing at the Committee appeal process. Disputes over munitions applications were resolved successfully between office chiefs of Defense and State.

Issues 5 and 6, I will address concurrently, since the conclusions are the same and the issues relate to whether current licensing processes adequately take into account cumulative effect. We found that the license process at the Defense Threat Reduction Agency occasionally takes into account cumulative effect, but that participants in the licensing process do not routinely analyze the cumulative effect of proposed exports or receive assessments to use during license reviews. In addition, Defense did not conduct required annual assessments that could provide information on the cumulative effect of proposed exports.

As of March of this year, the Defense Threat Reduction Agency had initiated action designed to increase the degree to which cumulative effect analysis was incorporated into the licensing process. We recognize that organizing and resourcing a meaningful cumulative effect analysis process poses a significant challenge, but this is clearly an area that needs more emphasis.

Issue 7 questions whether license applications are being properly referred for comment to the military services, the intelligence community, and other related groups. We determined that Defense components, except Defense Intelligence Agency, received about the same number of case referrals over the past 8 years. However, the Defense Threat Reduction Agency did not always appropriately refer applications to other Defense components for review. Of the applications we reviewed, various components considered that 12

percent of the dual-use and 24 percent of the munitions license applications had not been properly referred.

Issue 8 questions whether license review officials are provided sufficient training and guidance. We concluded that Defense organizations involved in the review process receive appropriate guidance. Nearly all licensing officials told us that the guidance was adequate for performing their duties. Licensing officers also stated that they generally had sufficient training. However, some officials believe that a classroom training program and training for personnel reviewing export licensing applications should be established. We concluded that putting more emphasis on training would be prudent.

Issue 9 questions the adequacy of the databases used in the licensing process, such as Defense Foreign Disclosure and Technical Information System, FORDTIS. We found that FORDTIS provides a useful communication and coordination mechanism for the Department on export control matters, although limitations exist in the system that reduce support to decision makers. In addition, inadequacies exist in the use of FORDTIS to provide an audit trail for export licensing decisions.

Issue 10 notes that a Defense licensing official has described instances wherein licensing recommendations he entered into FORDTIS were later changed without his consent or knowledge. We found that instances have, in fact, occurred in which recommended positions entered in FORDTIS by a licensing officer were changed without the consent or knowledge of that officer, although the number of such occurrences could not be determined. These changes are, however, permissible under existing Department policy and appear to have been based on supervisors' disagreements with licensing officers' conclusions. We note, however, that the documentation related to the changes was not always complete.

Issue 11 questioned whether license review officials are being pressured improperly by their superiors to issue or change specific recommendations. We interviewed all Defense Threat Reduction Agency licensing officers, and with one exception, they indicated that they had not been subjected to any improper pressure to change specific recommendations on license applications. However, several staff members stated that management applied indirect pressure and encouraged certain viewpoints.

Issue 12 asked whether our government still uses foreign nationals to conduct pre-license or post-shipment licensing activities and whether such a practice is advisable. In general, Commerce and State conduct these activities. Defense provides limited support to them through our Defense attache offices, and we also monitor certain foreign space launch activities under the provisions of munitions licenses. Defense has not used and does not plan to use foreign nationals to support these efforts.

Issue 13 questions whether the licensing process leaves a reliable audit trail for assessing license performance. We concluded that FORDTIS provides a long-term audit trail but does not always contain complete and accurate records of Defense and U.S. Government positions. As a result, the audit trail cannot be used as a reli-

able means of assessing the degree to which Defense positions are in agreement with positions taken by the U.S. Government.

Finally, issue 14 asks that we examine the procedures used to ensure compliance with conditions placed on export licenses. The Defense Threat Reduction Agency has adequate procedures for monitoring foreign space launch activities. An informal process for reporting potential violations of license conditions and technology assessment control plans was also adequate. However, we found that the expected increases in the number of launch monitoring missions, coupled with a programmed increase in staff to support these missions, dictate that the Department move to a more formal approach for reporting violations.

As a result of our overall review, we made numerous recommendations to the Department to improve the effectiveness and efficiency of the export licensing review efforts. In this regard, we recommended that the Department take measures to clarify responsibility for cumulative effect analysis and to improve both FORDTIS and internal procedures so as to ensure that better data is available for licensing officials. Additional recommendations involve such things as improved training and enhanced coordination with State and Commerce.

The Department was generally responsive to our findings and recommendations. We will be tracking progress on the agreed-upon actions for our audit follow-up process.

In conclusion, Mr. Chairman, we hope that this extensive multiagency review will be useful to both the involved agencies and the Congress as efforts to update and improve U.S. export licensing practices continue. That concludes my statement.

Chairman THOMPSON. Thank you very much.

Mr. Mancuso covered the waterfront here, so feel perfectly free to be extremely brief. [Laughter.]

If you feel moved to add or subtract from what Mr. Mancuso said, feel free to do so, but do not feel that you are going to be compelled to.

Mr. Frazier.

TESTIMONY OF JOHNNIE E. FRAZIER,[1] ACTING INSPECTOR GENERAL, DEPARTMENT OF COMMERCE

Mr. FRAZIER. Thank you, Mr. Chairman. Mr. Chairman and Members of the Committee, I, too, am very pleased to appear before you today to discuss our review of the Department of Commerce's export licensing process for dual-use commodities.

Commerce's Bureau of Export Administration administers the Nation's dual-use export control licensing and export system for national security, foreign policy, and nonproliferation reasons. Based on our review of BXA and as generally supported by the findings of the other IGs, we determined that the interagency license review process is working reasonably well and has improved much since 1993.

The Departments of Defense, Energy, State, Justice, and the CIA now review many more of the license applications submitted to Commerce. In fiscal year 1998, BXA referred 85 percent of license

[1] The prepared statement of Mr. Frazier appears in the Appendix on page 73.

applications. That is up from 53 percent in 1993. Clearly, this multi-agency review brings divergent policy views and more information to bear on license decision-making. In addition, the four-level escalation process for resolving license disputes among the referral agencies is working relatively well.

While we found significant areas of improvement since our 1993 review, we also identified a number of issues that warrant the attention of the Commerce Department, the administration, and the Congress. First and foremost, it is time to push even harder for new legislation to replace the expired Export Administration Act.

There is also a need to clarify the licensing policy and regulations regarding the release of controlled technology to foreign nationals working in Federal and private research facilities, commonly referred to as deemed exports. We found a general lack of knowledge and understanding on the part of U.S. industry and the Federal laboratories about deemed export regulations and when such an export license is required.

A third area where we see the need for change involves the requirement that post-shipment verifications be conducted for every high-performance computer, or HPC, greater than 2,000 MTOPS that is shipped to countries of concern. Our review concluded that this is not an effective use of government resources. This requirement has enforced BXA to divert some of its enforcement resources to verify shipments of lower-end HPCs or on multiple visits to the same end users.

Mr. Chairman, in response to your question about the adequacy of guidance and training for licensing officers, we have mixed findings. We initially identified the lack of up-to-date guidelines as one of BXA's major weaknesses. However, near the end of our review, BXA officials issued new work guidelines for licensing officers and are considering further changes. We have also recommended that BXA establish a formal training program for all of its licensing officers to supplement the current on-the-job training.

In response to your question, Mr. Chairman, about the pressure on licensing officers, most BXA licensing officials reported that they had not been pressured into changing their recommendations on specific licenses. Two of the 36 licensing officers who responded to our survey question did State, however, that they have received some pressure from management, but our intensive follow-up on this question did not provide evidence to support these individuals' statements.

We did, however, have questions about BXA managers' instructions to the chair of the operating committee on her decision on a few OC cases. We advised them that if the chair makes a decision that BXA disagrees with, BXA should escalate the case to the Advisory Committee for Export Policy in order to avoid even the appearance that this process is not transparent.

The Commodity Classification Process, or CCATS, is another area ripe for improvement. First, BXA needs to improve the timeliness of its processing of exporter CCATS requests. Second, we recommend that BXA refer all Defense-related CCATS requests to both the Defense Department and the State Department.

As I stated earlier, I believe that the overall process is generally more effective because of greater interagency involvement. How-

ever, we still found problems. We are especially concerned about the licensing officers amending some existing licenses without interagency review, inadequate time being provided to the CIA's Nonproliferation Center for its end-use checks, and BXA's approval of licenses based on a favorable end-use check after the pre-license check was canceled. BXA management has agreed to correct or address most of these problems.

In addition, I would like to highlight two other problems that require interagency action and attention by the Congress. First, we found that the CIA and its Nonproliferation Center, at their own request, review only 45 percent of all referred dual-use export licenses. In addition, they do not always conduct a comprehensive analysis of the applications they do receive.

Furthermore, there is no mechanism to track the cumulative effect of technology transfers. Such cumulative effect, while admittedly difficult to determine, would be a very useful addition to the license review process. Another key missing element is the screening of all license applications against the Treasury Enforcement Communications System database maintained by Customs.

We also have recommended a change in the exporter appeals process. Once an export application has been formally denied, the exporter has the right to appeal to the Under Secretary of Commerce. Although BXA confers informally with the referral agencies before deciding on appeals, we believe that the interagency process should be formalized.

Regrettably, Mr. Chairman, we found that BXA is still not adequately monitoring license conditions, as we first reported in 1993. This means that BXA is less able to determine if licensed goods have been diverted to unauthorized end users and exporters may receive new licenses even if they did not comply with previous licenses. We found recurring problems with respect to end-use checks conducted by Commerce's U.S. and Foreign Commercial Service, including untimely end-use checks and the use of foreign service nationals.

And finally, Mr. Chairman, in response to your question about BXA's automated export licensing system, called ECASS, we found that the system's internal controls are generally accurate. At the same time, it is clear that BXA's automated information system is inefficient and needs to be replaced.

This concludes my statement and I will be glad to answer any questions.

Chairman THOMPSON. Thank you very much. Mr. Payne.

TESTIMONY OF JOHN C. PAYNE,[1] DEPUTY INSPECTOR GENERAL, DEPARTMENT OF STATE

Mr. PAYNE. Thank you, Mr. Chairman, and Members of the Committee. We appreciate the opportunity to testify today on this very important issue. I have a very brief statement which I will attempt, as you suggested, to make even briefer, based on the discussion earlier.

The Secretary of State is charged with administering the Arms Export Control Act for defense articles and services on the U.S.

[1] The prepared statement of Mr. Payne appears in the Appendix on page 94.

munitions list. Munitions are generally products that have been specifically designed for military application. In fiscal year 1998, State's Office of Defense Trade Controls processed over 44,000 munitions license applications.

The State Department also reviews, for foreign policy considerations, dual-use license applications referred by Commerce. During fiscal year 1998, State reviewed over 8,000 dual-use applications, which represent about 75 percent of all the applications Commerce had received.

In our 1993 review, we found fragmented licensing responsibilities within State, confusion at overseas posts about responsibilities for end-use checks and verifications, and a lack of program files and documentation. State has made improvements since the 1993 review, including consolidating the export license functions and improving documentation of the referral process.

During our current review, we found that, overall, the export licensing process is working as intended and the State Department consistently executed its export licensing responsibilities in accordance with existing policies. We found no significant inconsistencies or ambiguities in the legislative authorities that guide the export licensing process.

Based on a statistical sample of applications processed, we found that State referred all appropriate applications to other agencies for review and fully addressed all concerns that they raised. We found no evidence that State licensing officials had ever been improperly pressured by their superiors to approve applications. Finally, we found that an adequate and reliable audit trail existed for the processing of both munitions and dual-use licenses at State.

In addition to these improvements, we identified some areas which need further attention. State's formal process for conducting end-use checks, referred to as the Blue Lantern program, was created to verify the ultimate end use and end user of U.S. defense exports. Although State continues to refine its program, we believe that further changes are needed.

First, given the limited number of Blue Lantern checks each year, 418 checks out of 44,000 licenses in 1998, attention should be concentrated on the most significant munitions categories. In addition, State needs to more closely monitor and follow up on Blue Lantern requests assigned to overseas posts. We found requests that had not been addressed for almost a year. Also, the Department needs to assist posts with appropriate expertise for technical on-site inspections when they are required.

Licensing officers need additional training. State relies primarily on the apprenticeship approach, and although this provides important hands-on training, there is no formal training for new licensing officers. Training for more experienced licensing officers is practically nonexistent.

The current munitions licensing process does not fully measure cumulative effect of technology transfers. State can improve its assessment of the cumulative effect by expanding the use of trend analyses and other reporting mechanisms. Nevertheless, State represents only one piece of a much larger picture. To fully assess the cumulative effect, information on technology transfers resulting from munitions and dual-use exports and foreign military and

third-country sales need to be considered, as well as the internal capabilities of the specific country. A comprehensive assessment will probably require a joint effort with resources and coordination from various Federal departments and agencies involved in the licensing process. It likely will also require Congressional direction.

Many of the concerns cited above are symptomatic of a larger problem at the State Department, insufficient resources to meet the expanding licensing mandate. State has fewer employees, heavier workloads, and lower pay grades in licensing activities than its counterparts at Commerce and Defense. In fiscal year 1998, 16 State licensing officers processed over 44,000 applications. Processing times have also increased. In 1992, State took an average of 4.5 days to process a non-referred license application. It now takes an average of 21 days, and State's mandate continues to increase as responsibility for all commercial satellite cases was transferred from Commerce in March of this year.

Recognizing the need for additional resources and the recent statutory change in commercial satellite responsibility, Congress has recommended that State provide an additional $2 million to hire more senior-level personnel and support staff to improve the scrutiny of the export license applications, enhance end-use monitoring, and strengthen compliance enforcement measures. Earlier this month, State increased the export licensing budget by $2 million and plans to fund an additional 23 positions.

That concludes my statement, Mr. Chairman. I would be happy to try to answer any questions.

Chairman THOMPSON. Thank you very much. Mr. Friedman.

TESTIMONY OF GREGORY H. FRIEDMAN,[1] INSPECTOR GENERAL, DEPARTMENT OF ENERGY

Mr. FRIEDMAN. Mr. Chairman, considering the fact that I testified before you on June 10 on this subject, if it is the will of the Chair, I would be more than happy to forego an opening statement.

Chairman THOMPSON. Thank you very much. Mr. Rogers.

TESTIMONY OF LAWRENCE W. ROGERS,[2] ACTING INSPECTOR GENERAL, DEPARTMENT OF TREASURY

Mr. ROGERS. Well, that is fast. Thank you, Mr. Chairman. I appear here today on behalf of the Treasury IG and, basically, our role in answering your letter from last year has been to look at the process that goes on in Customs, the last check-point as materials, goods leave the country.

I would like to be very brief and just say, generally, we noted that while we were not involved in this earlier report, I think it is good we are here now. Customs has made the outgoing check on goods as one of their core groups. We looked at their process and found several things that we reported as issues, among them being untimely export reporting data that comes after departure, which makes it very difficult to target enforcement effort. We think that there needs to be an improvement in the internal Customs license

[1] The prepared statement of Mr. Friedman appears in the Appendix on page 104.
[2] The prepared statement of Mr. Rogers appears in the Appendix on page 119.

enforcement efforts, better training, staffing at checkpoints, and so forth.

We also think that there is an issue about slowness in response to data inquires from Customs to the Department of Commerce, noted also by the Department of Commerce, I think, that the applications that are being processed by Commerce and State are not routinely screened against the Treasury Enforcement Communications System, but this is one of the issues that Customs agreed to take on, and, in fact, I would like to say that in every case, they have agreed with the recommendations and are undertaking some ameliorative effort to correct them.

Overall, we hope that the recommendations are helpful to them and we think they have been. I would say also that some of our report has been classified for limited official use only because of our concern and Customs' concern that details about their operations at the borders might enable people to avoid Customs controls at exit points.

With that, sir, I will conclude my statement.

Chairman THOMPSON. Thank you very much. Mr. Snider.

TESTIMONY OF L. BRITT SNIDER,[1] INSPECTOR GENERAL, CENTRAL INTELLIGENCE AGENCY

Mr. SNIDER. Thank you, Mr. Chairman. I will also try to be brief, in view of your admonition.

The CIA supports the export licensing process at State and Commerce by providing relevant intelligence information that is available within the agency on end users and intermediaries identified in export license applications. The CIA obtains this information in the normal course of its activities to gather and analyze information on proliferation activities around the world and on programs that other governments have for developing weapons of mass destruction.

The agency also provides additional support to the licensing process by preparing and providing finished intelligence reports and briefings on the results of its activities and through its participation in a number of the advisory committees that participate in the licensing process.

What we attempted to do in our review was to look at what the CIA is currently doing to support this process and identify ways that the Agency can improve its support. We found, first, that not all of the agency databases that might reasonably be expected to contain relevant information on end users were routinely being searched by the analysts doing such searches. We recommended that this be corrected.

Second, we found that the searches undertaken by CIA analysts were not being documented in a uniform way, either in terms of what was being done as part of the search or in documenting what was being reported to the Commerce and State Department. We recommended that be corrected.

Third, we believe that the response time of 9 days which the CIA has to review cases from the Department of Commerce is unrealistic and cannot be satisfied within the existing staff resources of

[1] The prepared statement of Mr. Snider appears in the Appendix on page 127.

the Nonproliferation Center. It is recommended that the agency work with Commerce to establish a more realistic response time and then that the agency staff its analytical capabilities accordingly.

Fourth, we found that Commerce does not fully appreciate the nature and limitations of the agency's capabilities to support the licensing process, and in turn, we found that agency analysts did not always understand or have a clear perception of the licensing officer's needs. To remedy this, we recommended a full-time agency liaison officer be assigned to Commerce to help bridge the gap.

Finally, we saw the need for guidance to the agency analysts who were providing support to the licensing process to ensure that they understand what management expects in terms of type of searches, the degree of searches that they are expected to do, and also guidance that provides for alternative reporting channels in those cases where sensitive intelligence information cannot be routinely included in end-user reports. We recommended that the Special Assistant to the DCI for Nonproliferation formulate this guidance.

In sum, while the CIA plays a limited supporting role in the export licensing process, we believe it can play that role more effectively and more efficiently. Indeed, I might add, Mr. Chairman, that the offices involved in the process at CIA have, in fact, taken steps to improve their performance as a result of our inquiry, so I think it is already having salutary effects on the agency's performance. Thank you very much.

Chairman THOMPSON. Thank you very much.

Senator Collins, do you have any preliminary comments before we get started here?

Senator COLLINS. I do not, Mr. Chairman. I just want to thank you for holding this hearing. This is a very important issue that the Committee has been involved in for some time and I salute your leadership.

Chairman THOMPSON. Thank you very much.

Gentlemen, thank you very much. As I said, your reports are very comprehensive. You have had quite a long time to work on this and it shows. I congratulate you for that.

I do not necessarily agree with some of the assessments. Your factual analysis, I think, is probably unassailable, but the idea that some of these things are working reasonably well kind of depends on what you expect and what you call reasonably well.

I mean, it is true, for example, that more cases are being referred out to these other agencies and the Executive Order did that. That is a step in the right direction, but when you look and see that they have less time to deal with these complex matters and there are more of them to deal with, and that they are not getting adequate training, and then you find that when they object, they are immediately rolled and there is no appeal taken—you have this nice, beautiful appeal process, but it is not being used. Nothing has ever gotten to the President. Nothing has ever even gotten to the second level of appeal. So, I mean, it depends on what you think is working reasonably well. The process is there. You talk to most of the managers and I am sure they will tell you that things are working just great.

It is your job to be objective and you have been and I appreciate it, but it is our job to be skeptical, so we are going to have to go through these things one at a time and maybe try to get underneath the surface a little bit.

There are so many issues here and so many departments, the best way to handle it maybe is to go back to the questions that we originally asked, and that is kind of the way that you have dealt with it in your report. We will see how far I can get there. I will not go through all of them, Senator Collins, before I turn to you, so do not get too concerned.

The first two have to do with the statutory framework, and the second question also has to do with the Executive Order pursuant to the statute and how that is working. Basically, you think the statute is not ambiguous, and that is fine. I believe you all recommend or think it would be a good idea for the Export Administration Act to be reauthorized, is that basically correct?

Mr. FRAZIER. Yes, sir.

Chairman THOMPSON. Was it you, Mr. Frazier, who said, for example, that we need to let the world know we are serious about this? If nothing else, that would do that. Is that correct?

Mr. FRAZIER. That is correct. I think that anything that we can do to remove the ambiguity, the confusion, to send signals not only to the rest of the world but to all of the referral agencies. So I think that is the first step, getting the Act reauthorized.

Chairman THOMPSON. The Executive Order, of course, set up this escalation process, whereby the agencies will get together. First of all, you have an operating committee that is chaired by an employee of the Department of Commerce, and we can talk about that a little bit more in a minute, but the operating committee considers these licenses. The licenses that are referred to the operating committee are growing, as I recall. Every year, there are more and more coming in to that level. It consists of representatives from all the relevant departments and agencies, and I believe they are at the operating committee level. I think we will have a chart here in a minute that will show that.

Basically, at that level, the chair of the operating committee can basically do what she wants to do. She is supposed to listen, but she can make the determination at that level herself as to whether or not to approve or not approve a license or approve with conditions, is that basically correct?

Mr. FRAZIER. That is correct, but what we find in practice is that she surely works to achieve a consensus. In one instance, I think, we made reference to the fact that she felt that she had been pressured in a couple of cases to advance the BXA position. What we have said in that regard to BXA is that they should treat her as an independent person. If there is a problem, they should then have it elevated to the next level. But she is a Commerce representative.

Chairman THOMPSON. Right. I was thinking more of the framework right now, more than actually how it works in practice. But your points are well taken.

Then if one of the agencies wants to appeal that, it goes to the Advisory Commission on Export Policy, and that is comprised of

people at the assistant secretary level or some confirmable position, as I recall it, with the advice and consent of the Senate.

Mr. FRAZIER. Correct.

Chairman THOMPSON. Then, if an agency is dissatisfied there, they can go to the Export Administration Review Board. Then the next appeal is to the President. So that is the process this Executive Order set out, and we can discuss that in a little bit more detail.

I think one of the things that was pointed out that the Executive Order did not address, and the law apparently does not address at all, is what about exporter appeals? You have got this process where it comes into Commerce, Commerce refers or chooses not to refer to these other agencies and so forth and everybody has their input and it is supposed to be considered. But if an exporter is denied and he appeals that denial, there is a danger that he can circumvent that whole process if he gets the initial decision overturned by Commerce alone. Is there not a danger that he can circumvent that whole process and wind up with his license without having to go through the process?

Mr. FRAZIER. Well, it should not work that way. One of the things that they do now, and it is through an informal——

Chairman THOMPSON. You mean it should not work that way?

Mr. FRAZIER. There is an informal process that exists now. The final decision is left to the Under Secretary for BXA. He makes the final decision on the appeals. However, we could not find an example where he made that decision without going back to the appropriate referral agencies, and what we are recommending is that process be formalized. As it is now, it is an informal process and in practice, he looks for the input.

Chairman THOMPSON. But I think throughout this, it is important for us to keep in mind and for you gentlemen as Inspectors General, what you go in there and they tell you how it works, that is important. You can listen to them and we will give them the benefit of the doubt on some of these credibility issues and so forth, despite the Rudman report.

But the formalized process is what we first of all need to look at. I am not too interested in the fact that somebody who is in charge of it says that it is working good and he picks up the phone and does this, that, and the other. The fact of the matter is, right now, there is no process—I mean, it can work exactly as I suggested and what you are suggesting is that be changed.

Mr. FRAZIER. Yes. In fact, Mr. Chairman, one of the points that you mentioned was that you, as the Chairman, are skeptical. I think, as the IG community, that is exactly the mantle that we wear very proudly. We think that this process should be formalized. I think that the point you make is right on the money.

Chairman THOMPSON. Thank you. The third question was to please determine if there is a continued lack of interagency accord, as stated in your 1993 interagency report regarding whether the Commerce Department is properly referring export license applications out for review by other agencies. I am going to broaden that a little bit. This really has to do with how the whole process works. I want to go through a few points here and see if we can discuss them a little more.

This timing situation was very much of a surprise to me, and Mr. Snider referred to the problem that the CIA has. Anybody who has ever dealt with the Federal Government has been exasperated. It takes forever to do anything, and yet it looks like, in dealing with dual-use export items, it is absolutely imperative to get everything done in as short a period of time as possible. We have the CIA being given 9 days to check out end users. Mr. Snider, what is the problem with that?

Mr. SNIDER. The problem with that is it is simply not enough time for the analysts who are overwhelmed with many cases to do that kind of an analysis.

Chairman THOMPSON. And the cases are escalating, are they not, the numbers?

Mr. SNIDER. The number of cases is escalating, the number of databases they have to check, people they have to consult are increasing, so timing is a problem.

Chairman THOMPSON. For the uninitiated, when I say check out end users, what are we talking about here? What are they doing?

Mr. SNIDER. Well, end-users are people or companies who are identified in license applications as being the ultimate recipients or the intermediaries to receive the technology or equipment in question that is being exported. And what we do is attempt to see what information the agency may have that might bear upon a decision to license such an export.

Chairman THOMPSON. In other words——

Mr. SNIDER. They may be involved in proliferation activities that the agency has detected heretofore, this sort of thing.

Chairman THOMPSON. In order words, you look and see who the actual end user is probably going to be, and what their activities have been, and whether or not they are the kind of people you want to have this technology.

Mr. SNIDER. Correct.

Chairman THOMPSON. Then you also look, do you not, at the likelihood that this might not really be the end user? This might wind up in somebody else's hands and somebody else not on the application is really the end user.

Mr. SNIDER. That is correct.

Chairman THOMPSON. So that is not an overnight process, is it?

Mr. SNIDER. No, it is not.

Chairman THOMPSON. I mean, you are dealing with foreign entities and we are dealing in a world now where you have all these partnerships. You talk to the Russians, you talk to the Chinese, and when they get caught red-handed in some of the proliferation activities, they say, well, that was not us, it was one of these companies out here and we really do not have much control over these companies, and they do joint ventures a lot and various kinds of entities are together and they are the end user.

Mr. SNIDER. You are correct.

Chairman THOMPSON. So you get 9 days in order to check all that out. The Department of Defense components, and when we say Department of Defense components, we are talking about, what, Army, Navy, and all the——

Mr. MANCUSO. Right, and the intelligence agencies and any other Office of the Secretary of Defense components.

Chairman THOMPSON. When they are brought in, when these matters are referred to them, I believe they get 10 days to make their assessment, is that correct?

Mr. MANCUSO. That is correct. And, in fact, what we found, for instance, in the Navy is that the 10-day period has forced them to adopt a system whereby they no longer refer the matters for review down to the appropriate commands, but rather, they rely on whatever front office or headquarters expertise they have developed to make those decisions, because getting it down to the people who would best be able to analyze it could not be handled within the 10-day period.

Chairman THOMPSON. That speaks for itself.

The Bureau of Export Administration, I believe, only has 9 days from the filing of the appeal within which to make a decision?

Mr. FRAZIER. From the filing of an application.

Chairman THOMPSON. I am sorry, for an application for a license?

Mr. FRAZIER. Yes.

Chairman THOMPSON. They have 9 days, and within that time, they have to decide what?

Mr. FRAZIER. They have to make a lot of decisions in that period. They have to look at the reasonableness of the application to see if it seems to have merit, to see if it is logical, what is included in the application, and then they have to make a decision as to who it is going to be referred to. You would hope that they would check their database, which is ECASS, they would go to other sources that are available to them to decide what should happen during those 9 days. I surely agree with Britt that the 9 days that the CIA has to look at these licenses that are referred to is unacceptable. It is not enough time. I think that is something that definitely needs to be examined.

Chairman THOMPSON. Chronologically, is it accurate to say that the Bureau of Export Administration wants this CIA assessment before they make their determination?

Mr. FRAZIER. Well, no, not necessarily. In fact, one of the things that they will be doing, when an application comes in, they will be making an assessment as to whether it has to go to the CIA.

Chairman THOMPSON. I see.

Mr. FRAZIER. In fact, we had a chart that had the process. I do not know if that is available.

Chairman THOMPSON. So that comes first. I think I understand what you are talking about.

Again, in terms of the process, I think more than one of you were concerned that we are not taking advantage of the technology we have over at Treasury to check these people out, to check these exporters out, to run them through their database over there to see what kind of record these exporters have. Customs, I guess, is where the records lie, and that this has been a problem.

Mr. FRAZIER. Yes.

Chairman THOMPSON. You have pointed these things out before in prior reports. Why do they not check? The conditions on these licenses are really only as good as the people carrying them out, and so who the exporter is is important. So let us see whether or

not they have prior violations, for example. Let us see what kind of citizens they are.

Apparently, Mr. Rogers, you have that information over there, but it is not being called upon. Is that a correct assessment?

Mr. ROGERS. The information is available. It is used to some extent, but time pressures, staffing and other limitations, from our perspective, it is not regularly used.

Chairman THOMPSON. Any further comments on that point?

Mr. FRAZIER. Yes, Mr. Chairman. We think that by automating that data—we have recommended since 1996 that they run the licenses against the TECS system and it just has not happened. We have been told recently that they are going to start working with Customs, but we will believe that when it happens because it is something that we have been on record about for at least 3 years, is suggesting that it should happen and it should happen immediately.

Chairman THOMPSON. All right.

Mr. PAYNE. Mr. Chairman, the State Department is one of the agencies that does not run each of the applications that it receives for munitions list items against the TECS system, but it does run the registration information. In order to apply for a license, you have to be registered, and at the time a company or an individual registers for a license that information is run against the TECS system. Now, there would be additional benefits to run the individual applications, as well, because they will sometimes have additional information, such as forwarders or other companies or organizations identified on the application that would not have been in the registration information.

This is something that State does not object to, sees a need to, but has attributed to a resource problem just the additional time needed to run each of the individual 44,000 applications against the database. So we are hopeful that as the resource problem is alleviated somewhat, that more of the application information will be run against the TECS system.

Chairman THOMPSON. With regard to what you are referring to, does that have to deal with munitions items alone?

Mr. PAYNE. Yes.

Chairman THOMPSON. So you are addressing the munitions side of things and these other gentlemen basically have been addressing the dual-use side of things. But it all gets back to what you are talking about, resources and time constraints. People are being required to do more with less and in a shorter period of time. That is what it amounts to, and that gives much more authority to Commerce, frankly, and the chairman of the operating committee on the front end. Those are policy things that we can discuss, but I think that picture is fairly clear.

I have one more question before I turn to Senator Lieberman, the fourth question that we asked. Please determine if the interagency dispute resolution or escalation process for appealing disputed license applications allows officials from dissenting agencies a meaningful opportunity to seek review of such applications and assess why this process is so seldom used.

We talked about that a little bit earlier, about the escalation process. But again, the time constraints here are interesting to me.

You go to the operating committee. A decision there is made by the chair, hopefully with consultation, hopefully with a consensus, but she has total authority. She has the power, if she chooses to exercise it, to totally ignore everybody, and in one case, with regard to encryption, she was told by her superiors at the Department of Commerce to ignore everybody. Does anybody dispute that?

[No response.]

All right. But however that works, I am sure it works fine in most cases. You can appeal her decision to the Advisory Commission on Export Policy, ACEP. You can appeal to ACEP and you have 5 days to appeal that case and it has to be signed by an assistant secretary. Now, I do not know how many people have experience in getting a busy assistant secretary's attention on anything important, or maybe even not so important. But 5 days to get someone at that level, to track them down and explain this case, you have to have burning ambition in order to do that, and it is reflected in the number of cases in which no appeal occurs.

So that is 5 days. Then if you are still of a mind, if you have not gotten the picture by then, you can go to the Export Administration Review Board, and you have 5 days to do that, and the secretary himself has got to do that to make that appeal.

This board has decided two cases since 1992. There have been two cases appealed to this board since 1992. The numbers are here on the chart, as you can see. Let us take 1998. The number of cases referred to the agency is 9,100. Then 766 cases were referred to the operating committee, and as we can see, those numbers have shown a general increase. They declined there for a while, and then after the Executive Order, they picked back up.[1]

But past the operating committee, the numbers have decreased. For the cases referred to and reviewed by ACEP, I guess 1993 was the highest on this chart, when 142 cases were appealed to ACEP. Last year, only 34 were.

With regard to the next level of appeal, to the Export Administration Review Board, in 1998, there were no cases. In 1997, one case. In 1996, none. In 1995, none. In 1993, none. You have to go back to 1991 to find any more, and you have got 20.

So, basically, what does that mean? I think one or two of you think that means the system is just working dandy because everybody agrees on everything. But I think, when you get into it and you talk to folks, like the Department of Defense you get a different picture. At Defense, for example, who took a sample of 26 cases. The Department of Defense, on this random sample, approved 6 and opposed 17, was their recommendation, almost a 3-to-1 rate of recommended denial over approval.

The operating committee approved 14 of those licenses over Department of Defense objections, and the Department of Defense only appealed one case. Out of that whole batch that you checked, the random sample, they only appealed one case. You talked to them about it, and apparently they told you. But after initially opposing these licenses, the Department of Defense later changed. Of these 14 cases, 9 of the 14 were with regard to China, India, and Russia on issues of risk of diversion and end user. But apparently,

[1] The chart referred to appears in the Appendix on page 47.

after a little discussion, the Department of Defense decided to go along with the licenses, with conditions. Now, we will learn later that nobody follows up to see if the conditions are complied with, apparently.

They told you that, well, "we look at the likelihood of success on appeal"—it is kind of like an intersection lawsuit, I guess, that you lose in court—in which you decide whether to appeal based upon the likelihood of success and how important it is. Then they said that they felt like they were required to have concrete evidence that the end user is a high diversion risk and they felt like that was obviously a high standard to have to have—though I do not know how much more evidence they would need with regard to China and India and Russia. Our own CIA calls China the world's greatest proliferator of weapons of mass destruction.

But, anyway, they wind up basically going against their own judgment. They approved 6 and denied 17. They wound up basically going along with everything and appealing only one. Mr. Mancuso, and correct me if I am wrong on my analysis, tell us what additional information you have about that.

Mr. MANCUSO. I have very little——

Chairman THOMPSON. Tell us as to why they did not appeal more.

Mr. MANCUSO. You are certainly factually correct in your description of the numbers and of what happened. We queried them on each of the cases and they had a variety of reasons. Some of them, they moderated their position after considering that the items were, in fact, in support of international programs.

Chairman THOMPSON. What does that mean?

Mr. MANCUSO. In general, it means that it was not a single application. It was going to be a broader application that had wider ramifications and they considered that fighting the denial for this one specific country apparently would have little overall effect and they, again, moderated their position.

Chairman THOMPSON. Does that mean that there were broader foreign policy objectives involved? I saw where you said, in support of international programs, and——

Mr. MANCUSO. That is correct.

Chairman THOMPSON [continuing]. I am still not sure exactly what that means.

Mr. MANCUSO. I think, in a minute, I am going to refer back to the person who handled the audit. But before I do that, in a number of the cases, they just simply felt that in reviewing their arguments, because as you escalate you begin to bring in higher-level officials within Defense and consider the appropriateness of the escalation, and they felt that they just did not have a strong enough policy argument to make at that level.

Chairman THOMPSON. So you have——

Mr. MANCUSO. I am certainly not saying that I would agree with that rationale, but it is their rationale.

Chairman THOMPSON. Let us think about this practically. I understand what you are saying and I appreciate it. But as a practical matter, this person who has this concern, or all these concerns with all these items, and this was a random sample of 26—goodness knows how many there are out there in terms of, say, the De-

partment of Defense objective—but he has to go to them and resist. The Department of Commerce, who is primarily in charge of this, and presumably some other of our agencies, will then presumably say we are all on the same team here and this is what we want to do. But this person who thinks its a bad idea still has to get to Mr. Assistant Secretary, within 5 days and convince him to go against that grain.

I am not passing judgment on whether or not he should, but that is the practical reality of what he has to do in order to escalate it to the ACEP level, is that basically correct?

Mr. MANCUSO. That is correct, and I guess in the colloquial sense, we all say, how often do you want to expend that silver bullet? And they looked at each one of these issues and in their own reasoning and with their experience, they decided on each of these issues to either accept conditions or to not seek a further level of appeal.

Chairman THOMPSON. Do they actually change their denial to approval in some cases?

Mr. MANCUSO. I believe in some cases, they went with——

Chairman THOMPSON. With conditions?

Mr. MANCUSO. The term is "approve with conditions." In others, they simply let their objection stand on the OC level but failed to follow up within the 5 days to seek appeal. So the record would reflect the objection.

Chairman THOMPSON. One final point. Is it not also true that there is no documentation on why appeals were not taken?

Mr. MANCUSO. In some cases——

Chairman THOMPSON. Basically, you are going back and talking to them about it, but in terms of a paper trail or in terms of an audit trail, it is very difficult to determine the reasons why appeals were not taken after objections had been lodged, is it not?

Mr. MANCUSO. That is correct, and that goes all the way back to the initial licensing officer's decision, where we spoke about the fact that we also found that supervisors, in some cases, changed the licensing officer's position without that person's knowledge or consent.

Chairman THOMPSON. We will get to that.

Mr. MANCUSO. And the facts behind that were not documented, as well.

Chairman THOMPSON. No reasons were given for that, either? We will have a chance to revisit some of these things a little later.

Senator Lieberman.

Senator LIEBERMAN. Thanks, Mr. Chairman. I wanted to get to the subject of deemed exports and the deemed export regulations. When we had the hearing on Mr. Friedman's report, this interested us in the basic notion that the exchange of technical information can be effectively an export and, therefore, evoke the same kinds of security concerns as the sale of a commodity. Therefore, it requires an application for a license, very few of which are filed, as Mr. Friedman's report showed.

I note that the Commerce IG has identified this issue as a more widespread problem than just at Department of Energy facilities. It appears that in addition to problems in the federally-funded labs, other agencies, including NIST at Commerce, Defense's Army,

Navy, and Air Force labs, and the Centers for Disease Control and Prevention have not submitted any applications on behalf of foreign nationals coming to their facilities.

I know that some people say that the problem here is in the ambiguity of the deemed export requirements and the Department of Commerce regulations. I just wanted to take that up a bit further, and perhaps I will start with Mr. Frazier. Are the Commerce regulations ambiguous, and if so, what can we do to help to clarify the application of the rule?

Mr. FRAZIER. Senator, they are, indeed, ambiguous. I looked at a couple of them myself, and when it explains the types of people who would have to come in to get an export or deemed export, it addresses the question of basic research without defining clearly what that means.

The other thing is that when we interviewed various people and we would ask them their impressions as to under what circumstances you would need to come in for an export license, most of them had varying interpretations and understandings as to the circumstances under which you would do that. Even at the Department of Commerce, we have our NIST labs and we were uncertain as to whether they, in fact, would be required. We know that there are various scientists and researchers that come to visit at NIST often, but not one deemed export license had been requested there.

It is something that I think is a big loophole. I think that most people do not have a clue as to the circumstances under which this should happen. We have encouraged BXA to try and come up with some better guidelines, to do more outreach, to get the message out, to target certain labs in the public and private sectors to make sure that they are aware of this. It is something that people just do not have a clue on. I think that is so unfortunate.

Senator LIEBERMAN. Is anything happening? Is anybody at Commerce responding to try to resolve the situation?

Mr. FRAZIER. In response to our report, they have, indeed, suggested that they will do more in this area, that they plan to do more outreach. I think that it is an area that there needs to be clearer guidance, there need to be some policy determinations made to clarify it. It should not be something that people have to go and make these assessments with these ambiguous guidelines. We think that it should be something that it is almost a checklist. If you have this, if this is going on, come in for the license. I would always encourage people, when in doubt, to come in and ask about the license anyway, but that is not happening.

Senator LIEBERMAN. Let me ask anybody who wants to comment whether you have any judgment or have reached any judgment on the underlying policy here. Is it right to have the category of deemed exports and to require license applications, leaving aside, for a moment, whether the regulation is ambiguous or not.

Mr. FRAZIER. I think that it definitely is.

Senator LIEBERMAN. It is?

Mr. FRAZIER. I think it is no question.

Senator LIEBERMAN. On the theory that I mentioned very briefly, which is that in the exchange of information, you can have as much either positive or negative occur as in the transfer of a commodity.

Mr. FRAZIER. Very definitely, even more so in certain cases.

Senator LIEBERMAN. Right.

Mr. FRIEDMAN. I would support that.

Senator LIEBERMAN. You would? OK. Let me go briefly to the cumulative effect problem that we talked about. I appreciate you drawing that to our attention.

What is being done now to assess the cumulative impact of controlled exports? Is there any response to the problem or is it totally running in separate pipes?

Mr. FRAZIER. Clearly, not enough.

Senator LIEBERMAN. No?

Mr. FRAZIER. I think, as the Chairman pointed out, people will look at one part of the dam. They will look at this hole, they will look at that, but very little is being done on a collective basis. In fact, when the staff who did the work raised that issue, I asked them to give me some ideas as to what kinds of things should happen. You are going to have to be willing to put a lot more resources into the issue. You are going to have to be willing to spend additional time. I think the Chairman has highlighted that repeatedly. Timing becomes an issue here. But it is something that is seldom done. It is an area that I think we are fairly vulnerable in.

Senator LIEBERMAN. Did any of you, in your work on this, or Mr. Mancuso, discover a specific case in which you were able to conclude that the availability of cumulative effect information might have changed the outcome of a particular application, or was the concern more—I do not want to demean it by saying theoretical, but that you saw a potential loophole here?

Mr. MANCUSO. No, Senator, only because we were not evaluating the appropriateness of each license application. Rather, we were looking at the process.

Senator LIEBERMAN. Yes.

Mr. MANCUSO. But I would add that when we looked, for instance, at the fact that there were a number of applications not referred to Defense from Commerce, we did a sampling of about 10 percent, and in 5 of the 60 samples, we found disagreement in Defense where Defense components felt they should have been referred.

Senator LIEBERMAN. Right.

Mr. MANCUSO. Three of those were cases in which Commerce had received an application regarding the transfer of technology to India. India was under Presidential order at the time that they could not ship items, so Commerce decided unilaterally not to share the application request with Defense. Well, that has a direct bearing on the cumulative effect analysis, because our license officials feel that even though Commerce was denying the license, we would want to know what was being requested, what was being looked for by this particular country, and we would have benefited from that.

If you are going to look at cumulative analysis, it is not just of the matters that are currently being referred. It is, overall, what are the items that are even being denied without the knowledge of the individual departments, such as Defense. So we certainly found some loopholes in looking across the board at all of these issues.

Senator LIEBERMAN. Let me move to that now. I know that DOD and DOE expressed concern that Commerce was not appropriately referring license applications to them for review, and the DOE ac-

tually rescinded its delegation of authority to Commerce, which had previously allowed Commerce to forego referrals to DOE of some license applications.

Does Commerce disagree with this expression of opinion from the Department of Energy and the Department of Defense that it was not referring all the licenses it should have to them for review?

Mr. FRAZIER. I think, as Don pointed out, we had a sample of about 60 cases that were not referred, and in looking at those, 5 of them should have gone to the Defense Department. BXA still took the position on reflection that they still felt that they had acted appropriately on all of them——

Senator LIEBERMAN. They did?

Mr. FRAZIER [continuing]. So I think that is their position.

Senator LIEBERMAN. Is any action occurring now within Commerce to respond to those concerns expressed by the other two agencies?

Mr. FRAZIER. In the case of Energy, I think it was returned without action. So the five that Don referred to were cases that we did both look at, and I think it is drawing a lot of attention to that process. We would think that the Department would have to be very careful in anything that it makes a decision not to refer.

Senator LIEBERMAN. Finally, I wanted to ask you to elaborate a bit on this interesting requirement for post-shipment verification of high-performance computers that I know was part of the Defense Authorization Act, I think, of 1998. That is the post-shipment verification to be conducted on all HPCs with a performance capability between 2,000 and 7,000 MTOPS that went to Tier 3 countries, which are countries that we have concern are proliferating. First, help us understand what the mechanism was supposed to be for a post-shipment verification.

Mr. FRAZIER. The issue here is that we would either have the U.S. and Foreign Commercial Service, which is stationed around the world in 67 countries, do it, or BXA's Safeguard Verification Program, where we sent export licensing agents from the United States overseas to verify shipments.

Senator LIEBERMAN. And the verification, obviously, is to make sure they are being used——

Mr. FRAZIER. That they have, in fact, ended up where they said they were going to end up. You go there and you verify that.

Senator LIEBERMAN. Is the purchaser required as a condition of the license to give permission for those post-shipment verifications to occur? In other words, what is the basis for us to go in through either the BXA or Commerce personnel?

Mr. FRAZIER. That is a general requirement. One of the things with China, China has always been a special problem because we exported, I want to say, in the neighborhood of 191 HPCS to them in FY 1998 alone.

Senator LIEBERMAN. Right.

Mr. FRAZIER. In the process, Commerce did only one HPC post-shipment verifications during that year.

Senator LIEBERMAN. That is exactly right. I was going to ask you about that. My numbers say 390 shipments of high-performance computers to Tier 3 countries in 1998, 1 year. Only 104 post-shipment verifications occurred, but, just as you say, of 190 high-per-

formance computers sold to China, only one post-shipment verification occurred.

Mr. FRAZIER. Yes. One of the things is that the Chinese Government requires that we get a special approval from them before these can be conducted. They usually go with the people from the United States who do the post-shipment verifications. The United States now requires exporters to obtain an end-user certificate from the Chinese Government for each HPC they plan to export to China, whether or not the export is licensed.

Senator LIEBERMAN. So do you think that change will increase the proportion of post-shipment verifications——

Mr. FRAZIER. Yes, because, basically, what it does is put the Chinese Government on notice that if these commodities, these high-performance computers, are going to be sent to them, it is unacceptable for them not to allow these verifications to take place.

Senator LIEBERMAN. But for now, we do know that of 190 high-performance computers sold to the Chinese last year, that we only have verified in one case that the computer is being used for what the representations were that it was going to be used for.

Mr. FRAZIER. Regrettably, that is true.

Senator LIEBERMAN. That is something I think we should focus in on, because as we see this emerging picture, we want to have trade with China, we want to have relations, economic and diplomatic, with China, but the picture we get of a very broad effort, basically, to obtain the technology that we have worked very hard and invested billions of dollars to develop and then perhaps to proliferate it, we have got to raise our guard. It just struck me that you all have pointed out one area here where our guard has been remarkably low, so I hope as we continue to oversee, and I ask your help in that, too, what the departments are doing, that we press in on this to see that more of that post-shipment verification is occurring.

Thanks to all of you. Thanks, Mr. Chairman.

Chairman THOMPSON. Thank you very much.

Mr. FRIEDMAN. Mr. Chairman, could I just clarify one point for Senator Lieberman?

Senator LIEBERMAN. Yes, please.

Mr. FRIEDMAN. I do not know whether you were relying upon my testimony from June 10 with regard to the withdrawal of the delegations of authority. You may well have been, because that is what we were told.

Senator LIEBERMAN. Right.

Mr. FRIEDMAN. In fact, Senator Lieberman, on July 11, the day after the hearing, I believe, the Department sent a memo to the Department of Commerce, the responsible parties there, not withdrawing the delegation but attempting to clarify the circumstances under which delegations will be appropriate. So it is a very different——

Senator LIEBERMAN. I see.

Mr. FRIEDMAN. The actual outcome turns out to be quite a bit different than what we had been told and we have not analyzed the contents of that document.

Senator LIEBERMAN. OK. So there is some negotiation going on now between the two departments?

Mr. FRIEDMAN. I do not know whether—I cannot tell you there is negotiation——

Senator LIEBERMAN. I appreciate that clarification. As a matter of fact, the delegation has not been withdrawn?

Mr. FRIEDMAN. That is correct.

Senator LIEBERMAN. Thank you.

Chairman THOMPSON. Thank you. Let us go back just a moment to the escalation process where we left off and the OC chair, the operating committee chair where the initial group discussion, at least, takes place. It looks to me like we could all benefit from a clarification of the role of the chairperson of that operating committee. We had a little discussion about this earlier. Consensus is said to be the practice, but the authority is clear and in some cases it has been exercised where unilateral authority could be exercised.

The Department of Commerce, as I read their response to all this, basically says, well, it says right there in plain English that she is an employee of the Department of Commerce and she is reflecting the Commerce position, and in effect, we make no apology about that.

I think you pointed out that at least the position was, or the desire was, when this was set up in the Executive Order, that she would be at least somewhat objective. I know, for example, in the encryption case, that she told you that she was told, basically, not to particularly pay any attention to what anybody else thought. Defense and Justice both, I think, had problems with that. She is not objective and she ought to be.

Mr. Mancuso, I think Defense was one that had a problem there. This is a policy decision. If, in fact, we want to set up someone in Commerce to have unilateral authority, at the initial stage, anyway—which, of course, in my estimation is extremely important because of the difficulties of going past that initial stage—that is a policy decision that I guess would be consistent with the Act. Or if we want to have someone who is supposed to be objective, that is another way to go.

It looks to me like we ought to lay our cards on the table and acknowledge what it is we are doing. Are there any recommendations in your report in terms of—I do not recall—clarification of that role, or do you have any thoughts? Mr. Frazier has discussed it a bit with me, but do you have any thoughts, Mr. Mancuso?

Mr. MANCUSO. As we stated in our report, we clearly feel that the process favors the Department of Commerce. That is the way the system was set up, that someone in Commerce would head up this committee, and it is assumed that the process would favor Commerce, which again leads to further analysis as to what might be an appropriate case to escalate.

In that regard, Mr. Chairman, I would respond to your earlier question about the international programs. My associate has told me that what we were speaking about there is the Israeli Arrow program, which has involvement that goes beyond Israel and has the support of the Department of State and other agencies. So within Defense, the Defense concerns were reevaluated in light of the feelings of the other participating organizations and the Department felt that their concerns——

Chairman THOMPSON. Your initial concern had something to do with them, and when you learned that they were a part of the process, that alleviated some of your concerns?

Mr. MANCUSO. Well, it also caused some belief that if the Defense Department position was not a very strong position, clearly, we would not prevail.

Chairman THOMPSON. All right. Back on this other point, what about the encryption issue? What happened there? Obviously, that is a very sensitive subject that we are dealing with up here right now. It is another balancing act. I am not sure where the administration stands on this today, but in times past, anyway, the Justice Department and FBI have taken the position that we have to be very, very careful about this. Some of our manufacturers over here want to loosen the standards and there is another debate going on here involving commerce with a little "c", commerce versus national security.

Encryption was at State at one time, was it not, and it was transferred to Commerce. Was that part of items taken off of a munitions list? Anyway, the transfer was made. Then Justice became a part of the process. Did that happen simultaneously, or exactly how did it come about that encryption came to Commerce, and does that sensitive item present a special problem? Apparently, it was the only time that the OC chair says that she was given those kinds of instructions back at Commerce as to how to deal with the subject. First, does encryption present a special problem for us? I do not want everybody to speak at once.

Mr. FRAZIER. I am not aware of the chronology. I think that what is tripping us up here is how it got to Justice. I just cannot address that point.

Mr. PAYNE. Yes. My staff just tells me that in 1996, the devices moved from the munitions list to the dual-use list and there is a process for moving items back and forth.

Chairman THOMPSON. OK. So it was like the satellites?

Mr. PAYNE. Exactly, like the satellites.

Chairman THOMPSON. Anybody on the staff may speak up if you want to. Was Justice involved in the process at that same time, or do we know?

[No response.]

All right. That is for further consideration.

On the cumulative effect issue, let us move on to question five. Senator Lieberman dealt with that. In the first place, I think it is important to point out or highlight what you point out in your report here. Mr. Mancuso, I think this is your part.

A Defense science task force report on globalization and security issued in December 1998 discussed how globalization and technology increases the need for those concerned with technology security to focus on the capabilities created by the integration and military application of uncontrolled technologies. A study released in early 1999 by the Department of Commerce discusses how the cumulative effect of technological transfers to China might pose long-term economic risk to U.S. competitiveness and suggested that the topic warranted further study.

In fact, in the Department of Defense policies and procedures directive 2040.2, international transfers of technology, the policy

states that DOD components—and we've discussed what the components were within DOD—shall annually assess the total effect of transfers of goods, munitions, services, and technology on U.S. security. So there seems to be a pretty clear policy directive that DOD is supposed to make such an assessment, is there not, Mr. Mancuso?

Mr. MANCUSO. Yes, there is.

Chairman THOMPSON. And that is not being followed, is it?

Mr. MANCUSO. No. We found that it is not. At best, it was performed on an ad hoc basis.

Chairman THOMPSON. My notes indicate that when you talked to them about it, they said that it was too costly and too slow to make the 30-day turnaround requirement that they had, is that correct?

Mr. MANCUSO. Correct. They attributed it to resources and timing.

Chairman THOMPSON. Resources and timing, a recurring problem. The only problem here is that you have an official who basically decides to ignore the policy of his own department. Hopefully, that is not commonplace. I just came from a hearing yesterday on Energy, you can tell, and we saw this time and time and time again over there. That is just something that we are not going to tolerate.

Congress needs to face up to the resources issue. Congress needs to face up to the timing issue, too, and perhaps we can address that in the Export Administration Act. It all gets back to the people administering the program, though, and what their ideas and proclivities are. If you have a bunch of people who so heavily weight things in favor of getting the merchandise out the front door, I am not sure any of the procedures are going to do you much good. Hopefully, however, we can do something about it, by pointing out the importance that this not be the prevailing attitude.

On number seven, the issue of whether or not cases were properly referred out to the various agencies for comment, Mr. Frazier, I believe that it was you who suggested that the CIA should get more time to look at these matters.

Mr. FRAZIER. Yes.

Chairman THOMPSON. You said in your prepared remarks, too, that they were not being referred as many things as you feel like they should be referred. In fact, here is the CIA apparently saying, we do not want all this.

Mr. FRAZIER. That is right.

Chairman THOMPSON. They had more important things to do. Therein lies another problem, right, Mr. Snider?

Mr. SNIDER. That is correct, Mr. Chairman. The Nonproliferation Center actually takes the position they are getting referrals they should not be getting, where the license application really does not involve the potential threat of proliferation activity or can be applied to proliferation activity. So there is a disconnect there.

Chairman THOMPSON. Who makes the determination as to whether or not it involves proliferation activity? How do you know that until you take a look at it? You have got somebody on the other end who does not have the qualifications to make that determination making it.

Mr. SNIDER. I am not sure how Commerce makes the determination. They refer the cases. They decide which should be referred under the MOU with the agency. They do that and then our analysts take a look at it and assess it from there.

Chairman THOMPSON. You generally describe the kind of cases you want?

Mr. SNIDER. Yes.

Chairman THOMPSON. And then they have to decide whether or not a particular case fits that category? What is the problem with that, Mr. Frazier?

Mr. FRAZIER. Well, the thing that we are trying to push, Mr. Chairman, is that when in doubt, send it. I mean, do not leave it to chance. You are right. The licensing officer has a body of information that he or she is working with. They get that. If they have any remote consideration that it should be referred, it should be referred. I just do not think that you leave it to chance. That is the message that we surely have tried to get BXA to address.

Chairman THOMPSON. All right. Clearly, this is something we need to have some further discussion about, and again, if it is a resources question, then it is something we need to face up to and Congress needs to face up to. We cannot have our cake and eat it, too, either.

Senator Akaka, it just occurred to me that I did not call on you. I am so sorry. I am going to stop right now and defer to you. You were here earlier and I got carried away.

OPENING STATEMENT OF SENATOR AKAKA

Senator AKAKA. Mr. Chairman, do not feel badly about that. I am patient and I know you have so many important questions to ask.

Mr. Chairman, I want to commend you for holding this hearing, especially after we have had an August 1998 investigation on the conduct of this interagency licensing process for dual-use items, and also a hearing that we had June 10 on dual-use and munitions export control issues relating to DOE.

Mr. Chairman, I want to ask that my statement be placed in the record.

Chairman THOMPSON. It will be made a part of the record.

[The prepared statement of Senator Akaka follows:]

PREPARED STATEMENT OF SENATOR AKAKA

Mr. Chairman, with you, I am pleased to welcome the Inspector Generals (IGs) from the Departments of Commerce, Defense, Energy, State, and Treasury and the Central Intelligence Agency to discuss their reports on the review of the export licensing processes for dual-use and munitions commodities.

I am heartened to learn that the IG's overall conclusion is that the dual-use referral and dispute resolution processes work reasonably well. The dual-use and munitions license processes have greatly improved since the 1993 review was completed. However, more work needs to be done to ensure that the United States has a highly efficient, effective and transparent export-control process.

Mr. Chairman, I, therefore, strongly recommend that the Committee invite the agencies to report on the measures taken in response to the IG's reports in 6 to 9 months. As the case with the 1993 IG reports, we do not want to wait another 5 years before someone reviews the actions taken by the agencies to implement the sound recommendations made by the IG's to improve the performance of our export-control process.

A catalyst issue for these IG reports was testimony last year before this Committee by Dr. Peter Leitner of Defense's Agency on Threat Reduction. He testified that recommendations he entered into Defense's computer system were later

changed without his consent or knowledge and that there was undue pressure to issue or change recommendations.

I am pleased to learn that, apparently with very few exceptions, although there have been instances of indirect pressure, this is not the case. Dr. Leitner's reporting was a serious concern to the Committee. I trust that with the IG's review of this issue and continued Congressional oversight future problems will be resolved.

Finally, Mr. Chairman, the various agencies generally agreed with the numerous recommendations made by their IG's for improving the export-control process, but they highlighted resource and budget restraints.

If the United States is to implement an effective, efficient and transparent export license control process, the Congress must ensure that the appropriations for each of these agencies is adequate for this purpose.

In light of the recent Cox Report findings and the additional funding granted to the Department of Energy's National Laboratories for implementing a secure counter-intelligence program, the Congress should consider appropriating funds for the specific procedures which need enhancements, such as Commerce's antiquated computer system, training, personnel resources for monitoring license conditions, end-user proliferation reviews and pre-license and post-shipment checks.

I welcome the witnesses and look forward to their testimony.

Senator AKAKA. I also want to say that I would hope that the Committee would not wait another 5 years before we hear from this group, that maybe even in 6 months, to see what has been done, and even more importantly, so that we can carry out your recommendations as they come from you, since you are the men in the trenches and have been able to see the problems that we have to face.

I have a question here for Energy. Mr. Friedman, you requested your general counsel to look into a possible conflict between Section 12(c) of the Export Administration Act regarding the protection of companies' proprietary information and the 1981 Executive Order 12333 regarding the United States' intelligence activities. What specific issues may be in conflict and what is the status of your general counsel's review on this issue?

Mr. FRIEDMAN. Let me answer the second part of your question, Senator Akaka, first. The last time I checked, which was about 3 or 4 weeks ago, the general counsel had not opined on that issue. They were waiting for additional information and they had not rendered an opinion at that point.

The general essence of the issue is whether export control analysts should have full access to intelligence data gathered by the Department's intelligence group and to raw information and others, conversely, whether the Director of Intelligence should have access to whatever information is generated as part of the export control licensing process within the Department of Energy. That was the technical distinction between those two documents that we asked the general counsel to render an opinion on.[1]

Senator AKAKA. Does the general counsel have any problems in that?

Mr. FRIEDMAN. I cannot speak for them. Certainly, waiting this long for a legal opinion on a matter of this sort is not acceptable and I am sure the current general counsel would agree with that, but I cannot——

Chairman THOMPSON. You ought to give them 9 days. [Laughter.]

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[1] The information entitled "Dual-Use License Process" submitted by Senator Akaka appears in the Appendix on page 132.

Mr. FRIEDMAN. My guess is this is a case that illustrates your point earlier, Mr. Chairman.

Senator AKAKA. In your report, Mr. Friedman, you indicated that the State Department does not have an established interagency fora to discuss routine munitions license applications and that there is no process for escalating disputed applications. What steps has DOE taken with the State Department to rectify these issues?

Mr. FRIEDMAN. Well, as I indicated on June 10, the under secretary has formed a task force to look at the broad range of export control issues and that is one of the issues on their plate. At this point, I, frankly, cannot tell you whether they have instituted any kind of discussions with the State Department on this matter.

Mr. PAYNE. Senator Akaka, may I address that from the State Department perspective?

Senator AKAKA. Yes, Mr. Payne?

Mr. PAYNE. On the munitions side, there is not an escalation process similar to the dual-use side. The State Department has the final authority to make the decision. Now, there is a fairly extensive referral of licenses to the Department of Defense and Energy and so forth and we are not aware of any specific cases where the State Department has not fully taken into consideration the concern expressed by the other agencies. It is true there is not a process, but we are not aware of any specific cases where there was concern by other agencies that the State Department ignored.

Senator AKAKA. It seems as though there either needs to be a process or we cannot let that fall between the cracks and disappear. Mr. Payne, the reports note that Commerce should fully implement 1996 NSC guidance on referring commodity classifications to state and Defense which could involve possible munitions items and that there should be more transparency in dual-use classifications, which should perhaps be open for all agencies to review. How many technical personnel, it could be engineers or whatever they are, are on State's Defense Trade Council, DTC's, political and military affairs staff, excluding any detailed personnel from the armed services? How many technical personnel are there?

Mr. PAYNE. I believe, currently, there are 16 licensing officers on the DTC staff.

Senator AKAKA. How many armed services personnel are detailed to both DTC and PM?

Mr. PAYNE. I am told four.

Senator AKAKA. If State DTC and PM do not have technical personnel on its staff, my question is, how can it perform commodity classifications under the Commerce control list, which is more complex than the U.S. munitions list?

Mr. PAYNE. I think the main concern the State Department has in wanting to see more of those commodity classification applications is that it would be able to spot those items that are not appropriately classified. For example, had that information in the Hughes case come to State, it would have objected to that information and Commerce's decision. I do not know how much additional technical capability State would need to review licenses, but State has only seen 21 of those classifications over the last number of years and there are something like 2,000-plus each year. State

would just like to have access to more of those so that it could express an opinion on the appropriateness of the decision being made.

It is true, State already suffers from a shortage of people and an inability to really perform the current responsibilities that it has, but we discussed earlier that there is a plan in motion to provide additional funding and to more than double the size of the staff in the DTC area.

Senator AKAKA. Mr. Snider, all of the IGs determined that our export license analysis will be better served if we have data on the cumulative effect of technology transfers. Do you believe the CIA is the appropriate organization with the U.S. Government to perform that function?

Mr. SNIDER. I am not certain the CIA necessarily has all the answers here. They certainly have a lot of information. It seems to me that, certainly, we are not looking at cumulative effect solely in terms of what licenses have been issued in the past and that sort of thing. We take into account lots of other factors in terms of what we know about what the country is producing indigenously, for example, what they are getting from third countries. There are factors that need to be taken into account, it seems to me, in the export licensing process but are not necessarily limited to cumulative analysis of end users and license applications. So I think intelligence has a critical part to play here in informing the export license process even beyond simply reporting on end users and intermediaries.

Senator AKAKA. The Commerce IG's report states that CIA's Nonproliferation Center is not fully engaged in the license process because it only receives about 45 percent of dual-use cases. Further, NPC only reviews applications for items controlled for proliferation reasons and not for national security for other foreign policy reasons.

Do you believe that the NPC could provide meaningful input on these types of applications and should it review a broader scope of dual-use licenses?

Mr. SNIDER. Well, let me respond this way, Senator. The dual-use applications are referred to NPC pursuant to an agreement, an MOU, between Commerce and the CIA that provides basically that applications will be referred to NPC that have some sort of potential implication for proliferation concerns. That is the business of NPC. That is what its analysts do and what they analyze.

Whether they can make a meaningful contribution in terms of analyzing the national security implications of other kinds of technology or goods or services, I rather doubt. That is not to say the agency itself could not provide analysis on these other topics, but I am not sure the NPC would be the correct place to do it.

Again, I think this is something that needs to be discussed between the Department of Commerce and the agency management to come up with a common understanding where we can play a useful role, if we are not fulfilling that role already.

Senator AKAKA. Thank you. I just want to touch on something that the Chairman raised about the issue of encryption. That is to anyone that would answer this. Is it not true that encryption software exports are still tightly controlled and that this is still an issue of debate in the software industry?

Mr. FRAZIER. The answer is yes. I mean, one of the things I see here even in my notes, that this is something that the National Security Agency is very much interested in. We know it is a hot issue at the Department of Commerce. So I think there is a debate. It has not been decided. There is a business concern that has been raised, a trade issue that has been raised. There are security issues that have been raised. I know the Justice Department has weighed into it. So the answer is definitely, yes, it is an issue that is being debated that needs more discussion and it will be interesting to see when it is resolved.

Senator AKAKA. I thank you for the responses. Mr. Chairman, you did accept my full statement, but in that statement, I am again asking and strongly recommend that these agencies report to us in 6 to 9 months rather than more than that.

Chairman THOMPSON. I think that is a very good suggestion. Thank you very much.

Let us move to the training issue again, because I have a hard time imagining bringing in these new licensing officers, especially in some of these sensitive areas—defense, for example—and not having any formal training period for them. They rely upon on-the-job training and mentoring. If that is not a way to keep total control of your new employees, I do not know what is, because that mentoring is going to reflect and the on-the-job training whatever the mentality of the people who are providing the mentoring. You might say the same thing with the formal job training, but I do not think so.

The thing that strikes me is that in the Federal law, Title 5, Section 4103, Mr. Mancuso, you point out with regard to question 8, the head of each agency shall establish, operate, maintain, and evaluate a program or programs and a plan or plans for training agency employees. The Department of Defense training policy, the directive carrying that policy out requires "heads of DOD components to plan, program, and budget for training programs to meet employees' development needs," etc. You checked with the Army and they have none. The Navy, they have none. The Air Force, they have none. The Joint Chiefs, they have none. Nor does DTRA, which does the technology assessments.

I would hate to think how someone would go over there and become a licensing officer and have to make a technology assessment for some kind of a component with nuclear ramifications without any real training. I guess I would do what they do for a while, anyway, and I would just kind of do what I was told. But they are not following the law.

I was struck with what these licensing officers are required to do. Mr. Frazier, I think it was in your report that you said that the operating manual being used by licensing officers at the time of our review included a small section entitled "case analysis guidance," which outlined eight points that must be addressed as part of the licensing officer analysis of an export license application and be included in the initial referral comments.

So before you can refer it, he has to consider: (1) export control classification. I am going to abridge some of this.

(2) background statement highlighting licensing history involving the applicant. Well, of course, we know we do not check with Cus-

toms or Treasury to find out the licensing history of the applicant. Information about this might come in over the transom, but that is one source we do not look at. The officer must also consider previous working group consultations, issues of interest, any precedent-setting aspects of the proposed transaction.

(3) the licensing officer has to consider the characterization of the end user, including type and relationship with the applicant, if any, such as a bank or a motel or a U.S. subsidiary.

The licensing officer, (4) has to consider the number of end users and the reasonableness of the end use. This is what he has got to do within 9 days, is it not, Mr. Frazier?

Mr. FRAZIER. Yes, sir.

Chairman THOMPSON. (5)—we are not through yet—reason for not referring to an agency.

(6) the licensing officer's written recommendation.

(7) statements as to whether or not conditions are appropriate, and if so, identification of the specific conditions of the Department of Commerce.

(8) the licensing officer's name, telephone number, facsimile number.

All these things this licensing officer has to do and there is no classroom training, and there is no plan, there is no program. There is no real training—all, I would submit, in clear violation of the regulations and directives of the Department. I think you all point out the need to standardize a training program.

Yes, you are able to go to some of these people and ask them, well, do you get sufficient training, and few of them are going to say, "No, we are basically flying blind here and do not know what we are doing." They did not report that. They basically feel like they are doing a pretty good job and they are up to it and all that, which you might expect.

But accompany this with the further findings that you had with regard to the pressure. Of course, you did not find many instances or many people who said much about that. There were some instances in the Department of Defense, but you could not really tell because there is generally no paper trail. You could not tell the extent of it, as I understand it, but you did get some instances of what was called indirect pressure. Some of these employees, and I assume licensing officers are included—if I am not right, you can point that out—said that they felt that promotions, bonuses, getting to travel, and things like that were at stake in terms of the extent to which they went along with the program management policy.

As I say, you accompany that with the fact that these people are not getting the training that is responsive to what they need and I think the picture emerges fairly clearly as to where the process heavily leans. In all these disputes and all these turn-downs, the people raising the question are always objecting to the license and the Department of Commerce is always overruling in favor of approving the license. That is what I've seen in all these samples, and if I am wrong, you can tell me. But that is what the dynamics are.

You have these agencies, at least in the beginning, anyway, who will say no but the weight and the burden—considering the stand-

ard of proof that apparently is being required—is in favor of granting the export license. Anybody can jump in here at any time, with the remote possibility that somebody might disagree with what I say.

Mr. FRAZIER. Let me jump in on the training issue.

Chairman THOMPSON. Yes.

Mr. FRAZIER. One of the points, I think, that you point out is the importance of training. Unfortunately, too often in government agencies, training is one of the first things that is cut. Too often, the people who are very busy doing their jobs do not have the time to get away for training. At least, that is the thinking of too many managers.

What we know is that as we try and improve this process, there should be a formalized training program that is in place, that we should be able to cross-train people with various agencies. I ought to be able to send someone from Commerce over to the Defense Department so that they can work on a brief internship, for example, to understand better what goes on, have people from the Defense Department come over.

One of the things that is happening in the Department of Commerce, one division has a very good training program that they have instituted for their new licensing officers. We are encouraging BXA to replicate that, if you will, because we can see in looking at those individuals, when they have a formal training program, that it is a better situation. It enables them to do their job better.

We have come up with many recommendations and ideas as to some of the things that can be put in place, checklists, examples, things that will make it easier, if you will, for the licensing officers to reach a decision. You just elaborated on the eight or so requirements that they have to deal with. I mean, there can be checklists that would, in fact, help them. There are some that exist. They need to be improved.

Training will make a big difference, because I think it will make sure that everybody is singing from the same song sheet, if you will. And at the same time, I think that to the extent that the other agencies understand what we are doing, to the extent that we understand what they are doing, it just has to improve the process. Something definitely should happen.

Chairman THOMPSON. I think that is absolutely right and I appreciate the clear recognition on behalf of all of you with regard to that. Not only is it the law, but it just stands to reason. People of varying levels of experience, I suppose, have to make determinations about end users. People did not come into the world knowing about practices of these various countries and all the complexities and arrangements that we were talking about earlier with regard to how they disguise what they are doing. We have also learned that some people do not always do exactly what they promise to us that they will do and that they are deceptive.

Mr. FRAZIER. And it changes daily. The fact that something was handled one way this week, it will not necessarily be the same next month.

Chairman THOMPSON. And we are constantly learning about how vulnerable we are to being wed to the old world kind of counter-espionage practices that we have, where we were set up and de-

signed to counter things that no longer exist, the Soviet Union, for example. Now, we have different kinds of threats from different kinds of countries and entities that work in different ways and it is not easy to recognize warning signs so that you can bring the CIA into it. If they never see it, I think it was your point earlier, then they are not going to be able to do their thing, either.

Mr. FRAZIER. Mr. Chairman, one of the other points that you rightly raise is the question of resources. For example, to do one post-shipment verification to a place in the Soviet Union may cost about $6,000. That is a resource issue. Someone that has a limited budget has to weigh that. Do you spend the $6,000 to take that trip to the Soviet Union or do you save that for training, do you save that for other trips? Those are the kinds of decisions that ultimately have to be made.

Chairman THOMPSON. Or is it just too expensive to ship a supercomputer to them under those circumstances?

Mr. FRAZIER. That is the other issue.

Chairman THOMPSON. Thank you for that. On the technology and information systems, this is another thing that it looks to me like we could make a lot of progress on. Mr. Mancuso, you talk about the DOD system, FORDTIS, is that the acronym for it?

Mr. MANCUSO. That is correct, Mr. Chairman.

Chairman THOMPSON. Basically, explain what it is, and maybe each of you might want to take a crack at that. Everybody seems to have their own database. There is some access, that you have one with another, but not total. Now, we learn that some of your departments are modernizing, but without talking to each other, so you do not know whether or not it is all going to fit together. We saw that with the Internal Revenue Service. That is part of the problem the IRS has. You have a bunch of great stovepipes, systems totally unrelated to each other and that cannot talk to each other. Is that where we are headed here if we are not careful? What do we have and what do we need, Mr. Mancuso?

Mr. MANCUSO. Well, basically, what we have is a system that is supposed to be a comprehensive reference database and it is supposed to track all of the goods, munitions, services, and technology.

Chairman THOMPSON. When you say "we", are you talking about Defense now?

Mr. MANCUSO. "We," meaning the Department of Defense are supposed to be doing that, and in many ways, FORDTIS does exactly that. On the other hand, it lacks certain controls and it also is not as easily accessible and relational to other databases that we may, in fact, be very much interested in.

We focused, in this case, on who can make changes in FORDTIS and who is responsible for updates and are those updates being made. What we found is that some of the problems with the system were actually planned, not as problems, but there was a rationale given as to why, for instance, supervisors could overwrite the positions of their licensing officers without any concurrent policy that would require some documentation in the system as to what the initial position was and the fact that it had been changed, etc.

We also found that, in looking long range, in tracking through end-use verification, etc., that frequently, there were not the updates to the system that would be needed and would be beneficial

for future reviews. So in a few instances, we found that the final Defense position recorded differed when we looked at the Commerce system, and vice versa.

Basically, what we have is a usable system that needs some work. We have made some suggestions to management as to what improvements could be made and suggested the importance of being able to relate clearly to the State Department and Commerce and others.

Chairman THOMPSON. Commerce is one of those departments that is attempting to modernize their system somewhat, as I understand it.

Mr. Frazier, you might take us through what happens. An application comes in. How does the system work now? What do you need to be able to call on within Commerce? What kind of information do you need? What do you rely upon? I assume that if Defense is brought in, then they look to their own systems. Do they need to be able to use yours or vice versa? What is the set-up now and what should it be, do you think? Do you happen to have a chart?

Mr. FRAZIER. There is a chart that Jennifer has put up that is on the entire process. But since you are primarily interested in the systems, our system at Commerce is called the ECASS system and that system is working. The problem is that, as I pointed out, that system was developed in 1984. It would be the same thing if you had a computer from 1984. It would still work. I mean, it is probably a 286 and it would still work, but it surely would leave you in the dark ages in many respects. There is so much information that is available that if we had an updated system, that the licensing officers would have right at their fingertips.

They could have information from a classified system, and that is an issue that we have to, I think, collectively agree, in terms of whether that information that would come from the CIA, for example, should be readily available to the licensing officers. It would have to be a classified system and that would have to be something that would have to be approved at the appropriate levels.

Chairman THOMPSON. Is that not one of the problems that you have now even with regard to an unclassified situation, and that is licensing officers not really having access to what is there?

Mr. FRAZIER. That is probably the number one problem. For example, the current system, it is working. That is what we point out in the report. However, it is not user friendly. So if while you are doing your research to answer those eight or nine questions on determining what should happen to a license, you need to stop and write a letter or something, you have to get out of that system. It is not user friendly. You cannot cross-link it with other systems that exist in the Department.

We are aware that the Department has requested a little over $2 million to begin to upgrade that system. That would be an investment that would be well worth the money. I think it would pay for itself in weeks, if not minutes. That is how important I think that this actually is.

This system can be the lifeblood, if you will, of the licensing process in terms of improving it. Information is the key here. As we try and encourage the other referral agencies to give us more information, that information should be in the system so that we can al-

ways deal with the questions that you raise, like an audit trail, so we can always have a history as to what has transpired on every case, that people have a record of really what happened. If somebody raises a question, that should be a part of the permanent record.

Chairman THOMPSON. That could even help on the cumulative effect issue, could it not?

Mr. FRAZIER. That is exactly it. I think when we talk about the cumulative effect, we are talking about information, and that is what cumulative effect means, getting information from as many sources as possible. Clearly, the CIA has a major role, the State Department, Energy, all of the referral agencies, but other sources, too. We need to get the information pulled together in such a way that we can deal with the cumulative issues. It is all about having a system. We have the technology readily available, again, and it is a relatively small investment from where I sit.

Chairman THOMPSON. What about the issue of DOD and DOC both trying to modernize without integrating much?

Mr. FRAZIER. The first thing we are saying, we probably have in here—I am looking at it—we have in excess of 30 specific issues that any changes to the ECASS system should address. But the most important recommendation that we have is that the system be developed in concert with the Defense Department and the other referral agencies. It would be foolhardy if these systems cannot talk with one another, cannot interact with one another, including the Treasury system and others. So that is the number one recommendation that we have. We think this should not be done in isolation. It is something that surely should be coordinated amongst the referral agencies.

Chairman THOMPSON. That is something we can talk to OMB about. It seems like it is a very important issue to me. Does anybody else have any comments on this issue or disagreements?

[No response.]

Mr. Mancuso, you mentioned the fact that on some occasions, the Department of Defense, there were some occasions when the recommendations of the licensing officer were actually changed. In the system, in other words, a change was made, and you point out that there is, I suppose, legal authority to do that. You do not have to accept the decision of the person working for you.

But beside that problem, or potential problem, the other problem is that there is nothing in the system to tell how many times that has happened or to tell what changes were made, what the original recommendation was, or what the override has and the reasons for that were. We do not have the benefit of that now, do we?

Mr. MANCUSO. Well, in part, we do, Senator, because the system allows for that information to be included, and, in fact, many times, that information was included and there is a clear trail that explains how and why a supervisor changed a subordinate's decision and, in fact, tracks through the rest of the process, as well.

But there were also numerous occasions where a licensing official told us that they had documented a particular opinion, found later that had been changed, and the system doesn't reflect that it was a change. You would think common courtesy, if not good manage-

ment, would have required that the supervisor alert the licensing official as to his or her intent to make a change and it is not there.

Chairman THOMPSON. And if you were the final decision maker, you would assume that this was the licensing officer's opinion when you were making your decision. So they are being misled.

Mr. MANCUSO. That is correct.

Chairman THOMPSON. You can understand that when there is a paper trail and reason, a person is willing to stand up and say, this is what I did and this is why I did it, that is fine. But changing it, not telling the licensing officer you are changing it, not giving any reason for it, and making it look like it is his recommendation, that is not done for any valid purpose in my opinion. What are you recommending that we do? Is this just a matter of putting down another policy directing that they quit doing that?

Obviously, this is a technology problem, in part, is it not? It gets back to the problem we were just addressing: Having the capability of putting the information in there so that you can have an audit trail, so that when these satellite launches explode and all the politicians start asking questions, you can go in there and find out who did what.

Mr. MANCUSO. And that is a primary recommendation that we are making, that the system needs to be adjusted to accommodate those changes and to reflect those changes so as to ensure a complete audit trail, from the earliest decisions by a licensing officer to the final DOD and U.S. Government positions.

Chairman THOMPSON. All right. On the end-user checks, part of the justification for lowering our guard, you might say, and allowing individual license grants, is that sometimes the government will say, well, OK, we are going to approve it. But we are going to put some additional conditions on it, but those conditions are no better than our ability to check up on these end users and check up on the exporters' adherence to the conditions.

So we have a system of, first of all, pre-license checks and then we have a system of post-shipment verification. As I read your reports, it really does not look like much emphasis is being placed on either of these.

Mr. FRAZIER. And, hopefully, those are the exceptions. That is when someone has to go from the United States. Most of the end-use checks would be performed by folks that are stationed overseas. But, of course, one of the real problems there is that they have other priorities. They have other responsibilities. Again, you get back to your question of timeliness.

Chairman THOMPSON. I believe you pointed out that some of them told you, anyway, that export promotion takes precedence over the pre-license checks and the post-shipment verification.

Mr. FRAZIER. That is their mission overseas.

Chairman THOMPSON. That is their job.

Mr. FRAZIER. That is right.

Chairman THOMPSON. They just happen to be over there, so we want to use them, but in addition, there is the question of training and do they really know what they ought to be looking for.

Mr. FRAZIER. We have raised the issue of training there, also. But in theory, Mr. Chairman, the folks who are overseas should be in the position to better identify the companies. They should know

a little more about the individual companies that these things have been shipped to. So, in theory, they should be in a better position to do the work, because they live in those countries, they deal with those firms on a regular basis.

Chairman THOMPSON. Senator Lieberman pointed out, with regard to China, anyway, that there certainly is hardly anything going on there. I wonder what reasons they give for not letting us verify that they are using our high-speed computers and sophisticated tools the way that they say that they are going to use them.

Mr. FRAZIER. The new changes suggest that, in certain computers, the ones that are the most sophisticated, that before a license will be issued, they are to get a certification from the Chinese Government that a post-shipment verification check will, in fact, be performed, will be allowed. So the message there is that if you do not agree to this post-shipment verification, then you will not get this computer, and that is a recent change. Hopefully, we will be able to see those numbers go up.

Chairman THOMPSON. That just has to do with computers?

Mr. FRAZIER. Yes, the high-performance computers.

Chairman THOMPSON. The exporters also are supposed to report actual shipments against the license that they have, but I believe you found that the Bureau of Export Administration does not really monitor that, do they?

Mr. FRAZIER. We found that BXA does do some monitoring of exports of HPCs and other commodities but that the level of monitoring is inadequate.

Chairman THOMPSON. So there is a diversion issue. I mean, how else are you going to feel comfortable about whether or not something is being diverted, is that correct?

Mr. FRAZIER. That is correct.

Chairman THOMPSON. We talked about the audit trail difficulties. I think each of you saw some problems there. FORDTIS is insufficient.

One of the things, for example, as you suggested, is that we could have more information with regard to what goes in on these operating committee meetings. For example, explanations of why decisions are made, should be more than just summaries. They should include what new information has been brought to the meeting by those who were there that should impact on the decision, why a department chooses not to escalate when they object. We do not have the benefit of that right now and we need it.

Mr. FRAZIER. If I can add, if there is one word that I would like to come out of the Commerce report, that word would be "transparency". That is the message that we are advancing here. We have not found anything that should be hidden, and so let us open it up and make people able to see what is going on.

Chairman THOMPSON. And transparency promotes accountability.

Mr. FRAZIER. Yes.

Chairman THOMPSON. That is what we are all striving for.

On the monitoring programs, in general, I think the burden there, as DOD points out again, is going to increase, the need for monitoring is going to increase. But, apparently, we are not adequately monitoring the license conditions. We talked about this, of course, before. We put these conditions on usually, I guess, for rea-

sons having to do with the end users, but we are not really monitoring whether or not those conditions are being carried out, are we, Mr. Mancuso?

Mr. MANCUSO. We are not.

Chairman THOMPSON. All right. We have gone through all 14 points at least once. I did not think we could get through with all the points I wanted to make today, but we did. This is just the beginning. This is an excellent piece of work and I want to thank all of you for what you have done and the time you have put in on this. Your job is not to reach subjective conclusions in the way that we have the luxury of doing up here. I know it is a fine line to walk sometimes that you have, but part of our job on this Committee is making sure that you are allowed to do your job. I think this report indicates that part is working reasonably well.

I must say, I come away from this very concerned, although this is not to say that everything has gone wrong. We have not had a cause and an opportunity to look at these various departments the way Senator Rudman, for example, and his people looked at one particular department. But to me, it is clear that we have got some real problems and they are under the radar screen. They are not espionage and they will never make the front page of the paper, and there is not any one thing that really grabs you that will make the evening news.

But when you put all this together, we come away with a picture that is troubling, to say the least. We are dealing with more and more complex issues all the time. We are asking more and more of these licensing officers. We are giving everybody less time to run the checks that they need. There is very little, if any, formal objective training, contrary to what they are required to give these people, no assessment as to the cumulative effect of what we are doing in this area, no real checks on the front end with Treasury and Customs as to the track record of these exporters, no real check on the back end as to what these people are actually doing with the dual-use items that we are sending them, and we have a process that basically is set up to make pretty sure that Commerce gets its way on anything that it really wants to get its way on.

These are my conclusions. I am not asking you gentlemen to adopt it. It is very cleverly set up and it was highly promoted and very effectively done, this appeal process, but it is just not being used and it is ineffective and it is designed to discourage people within the administration from rocking the boat. There is also the lack of training, and at least some people were able to talk about the fact that there is some informal pressure on them, that to get along, you go along. It is not a good picture at all. I think that we are hurting ourselves with the system we have.

Part of the problem is back here on this side of the table, too. Everything I have mentioned probably costs some money, probably not nearly as much as people in the departments say it does, but we have got to be able to restructure our own priorities and come up with the funding to do what everybody ought to know is necessary in terms of controlling these computer systems.

With that, job well done. Thank you very much for what you have done. I look forward to working with you in the future to see if we cannot go about resolving some of these problems.

Let us keep the record open for 1 week. We may have additional written questions or comments that other Members might want to submit to you.

We are in recess.

[Whereupon, at 12:45 p.m., the Committee was adjourned.]

APPENDIX

REFERRALS OF DUAL-USE CASES

FY	Cases Referred to Agencies [1]	Cases Referred to and Reviewed by the OC	Cases Referred to and Reviewed by the ACEP	Cases Referred to and Reviewed by the EARB [2]
1991	7,000	169	89	20
1992	11,100	333	105	0
1993	13,900	493	142	0
1994	6,800	281	97	0
1995	5,100	161	68	0
1996	6,800	435	71	0
1997	10,400	784	38	[3] 1
1998	9,100	766	34	0

[1] Data based on date actual referral occurred.

[2] Export Administration Review Board.

[3] One case was referred to the EARB in FY 1997; however, the EARB did not review it.

LETTER FROM SENATOR THOMPSON TO SIX AGENCIES

COMMITTEE ON GOVERNMENTAL AFFAIRS,
U.S. SENATE,
WASHINGTON, DC.
August 26, 1998

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DEAR INSPECTORS GENERAL: In 1993, the Inspectors General of the Departments of Defense, State, Energy, and Commerce collaborated to conduct an interagency review of the export licensing processes for dual-use and munitions commodities. I am writing to request that you update and expand your work in this important area, particularly in light of testimony the Committee received at a June 25, 1998 hearing. I have included the Inspectors General of Treasury and the CIA in this request because the 1993 interagency report concluded that those agencies played major roles in the licensing process.

On June 25th, the Committee heard from Dr. Peter Leitner, a senior strategic trade advisor in the Defense Technology Security Administration. Dr. Leitner pro-

vided an unsettling description of the dual-use review process. I urge you to read the hearing transcript, an unofficial copy of which is enclosed.[1] His testimony raised many specific areas of concern, but he also recounted, drawing on his twelve years of experience in this area, what he views as a general breakdown in our licensing controls:[1]

> [O]ver the past six years the formal process to control exports of dual-use items has failed its stated mission—to safeguard the national security of the United States. . . . Through a tireless campaign, the opponents of export controls have managed to destroy the 16 nation Coordinating Committee on Export Controls, decontrol vast arrays of critical military technology, rewire the U.S. domestic export controls process so that it is structurally unsound and unable to safeguard our security, and erect a series of ineffectual domestic regulations and international working groups designed to project a false impression of security, deliberation and cooperation.

(Hearing transcript at pp.7–8.) Although he took issue with some of Dr. Leitner's specific criticisms, a second hearing witness, Principal Deputy Assistant Secretary of Defense Franklin Miller, told the Committee there was room for improvement in the Department's handling of dual-use applications.

Your 1993 interagency report detailed a number of problems. For example, you described that in nearly a quarter of sampled cases referred for review to Energy by Commerce, the agencies maintained inconsistent information in their respective databases about a given case, a shortcoming which "tends to diminish the credibility of the licensing process." (Report at p. 20.) In addition, you noted that for dual-use licenses that required exporters to document compliance with certain conditions, the government received the required documentation in only four percent of cases sampled. The Commerce Department, moreover, had taken no steps to bring the 96 percent of nonfiling exporters into compliance. (Report at p. 3.)

While I leave it to your judgment to determine how best to examine the dual-use and munitions licensing processes, I ask that in performing the work you address the questions that are listed below. Please do not treat the following list as an exhaustive one; rather, it is suggestive, setting forth some issues arising from the Committee's June 25th hearing:

1. Please examine whether the current, relevant legislative authority contains inconsistencies or ambiguities regarding the licensing of dual-use and munitions commodities, and the effect of any such inconsistencies and ambiguities.
2. Please examine whether Executive Order 12981 (1995) as implemented is consistent with the objectives of the Export Administration Act and other relevant legislative authority.
3. Please determine if there is a continued lack of interagency accord, as stated in your 1993 interagency report (at page 13), regarding whether the Commerce Department is properly referring export license applications (including supporting documentation) out for review by the other agencies.
4. Please determine if the interagency dispute resolution (or "escalation") process for appealing disputed license applications allows officials from dissenting agencies a meaningful opportunity to seek review of such applications, and assess why this process is so seldom used.
5. Please review whether the current dual-use licensing process adequately takes account of the cumulative affect of technology transfers resulting from the export of munitions and dual-use items, and the decontrol of munitions commodities.
6. Please review whether the current munitions licensing process adequately takes account of the cumulative affect of technology transfers resulting from the export of munitions and dual-use items, and the decontrol of munitions commodities.
7. Please determine whether license applications are being properly referred for comment (with sufficient time for responsible review) to the military services, the intelligence community, and other relevant

[1] We request that you use the enclosed unofficial transcript for internal purposes only. We will forward you an official transcript once it is available.

groups (the "recipient groups") by the Defense Department and other agencies. Please consider in particular numerical trends in the frequency of such referrals, trends in the types of applications referred, trends in the nature of the taskings made in connection with the referrals, and the perceptions of officials at the recipient groups.

8. Please determine whether license review officials at each of the agencies are provided sufficient training and guidance relevant for reviewing license applications, and whether more formal training and guidance is warranted. Dr. Leitner noted a paucity of such training and guidance in his Committee testimony. (Hearing transcript at pp. 43–44).

9. Please review the adequacy of the databases used in the licensing process, such as the Defense Department's FORDTIS, paying particular attention to whether such databases contain complete, accurate, consistent, and secure information about dual-use and munitions export applications.

10. In his testimony, Dr. Leitner described instances where licensing recommendations he entered on FORDTIS were later changed without his consent or knowledge. (Hearing transcript at pp. 46–47.) Please examine those charges, and assess whether such problems exist at your agencies.

11. Please determine whether license review officials are being pressured improperly by their superiors to issue or change specific recommendations on license applications. Dr. Leitner testified about one such incident that happened to him at DTSA. (Hearing transcript at pp. 47–50.)

12. Please determine whether our government still uses foreign nationals to conduct either pre-license or post-shipment licensing activities and whether such a practice is advisable.

13. Please determine whether the agency licensing process leaves a reliable audit trail for assessing licensing performance.

14. Please describe the procedures used by agencies to ensure compliance with conditions placed on export licenses (e.g., no retransfers without U.S. consent, no replications, and peaceful use assurances), and assess the adequacy and effectiveness of such procedures.

I appreciate your prompt attention to this important project. If you need assistance or have questions about the request, please contact Jack Cobb or Maggie Hickey of the Majority staff at (202) 224–4751.

Sincerely,

FRED THOMPSON
Chairman

Hold for Release
Until Delivery
Expected 10:00 a.m.
June 23, 1999

Statement by

Donald Mancuso

Acting Inspector General

Department of Defense

Before the

Senate Committee on Governmental Affairs

on

Export Licensing Processes for

Dual-Use Commodities and Munitions

Mr. Chairman and Members of the Committee:

I appreciate the opportunity to be here today to discuss the Federal Government's export licensing process for dual-use commodities and munitions. In response to Chairman Thompson's letter of August 26, 1998, an extensive review has been conducted by Inspector General (IG) teams from the Departments of Commerce, Defense, Energy, State, Treasury and the Central Intelligence Agency. The efforts of the review teams were coordinated by a working group, which avoided duplication and enabled us to track individual export license application cases across agency lines and to address interagency issues. The results of our review are contained in the interagency report signed by the participating IGs on June 18, and six individual agency reports, signed by the respective IGs between May 28 and June 18.

Because my office assembled and published the interagency report, I will begin my testimony by summarizing its main points. I again emphasize, however, that the report represents a joint effort.

Background

Dual-use commodities are goods and technologies with both military and commercial applications. The dual-use export licensing process is governed by the Export Administration Act of 1979, as amended. Although the Act expired in 1994, its provisions are continued by Executive Order 12981, "Administration of Export Controls," under the authority of the International Emergency Economic Powers Act. Munitions exports are controlled under the provisions of the Arms Export Control Act.

The dual-use export licensing process is managed and enforced by the Department of Commerce while the munitions export licensing process is managed by the Department of State. The advisory roles of other agencies are similar in both of these license application processes. The Departments of Defense and Energy review the applications and make recommendations to Commerce and State. The Central Intelligence Agency and the U.S. Customs Service (Department of Treasury) provide relevant information to Commerce and State to assist them in the license review. Customs also enforces licensing requirements for all U.S. export shipments except outbound mail, which is handled by the U.S. Postal Service.

In FY 1998, the Department of Commerce received 10,696 dual-use export license applications and the Department of State received 44,212 munitions export license applications.

The overall objective of the interagency review was to evaluate the export licensing processes for dual-use commodities and munitions to determine whether current practices and procedures were consistent with established national security and foreign policy objectives. To accomplish this objective, we reviewed various random samples of license application review cases to determine if prescribed processing procedures were followed within each agency and in multi-agency groups.

Interagency Review Results

To a considerable extent, our June 18, 1999, interagency report is an update of a similar report that was issued jointly by the IGs of Commerce, Defense, Energy and State in 1993. The previous report, titled, "The Federal Government's Export Licensing Processes for Munitions and Dual-Use Commodities," covered the pertinent issues under seven headings. The current report is structured along similar lines.

The first area relates to the adequacy of export control statutes and Executive Orders. The IG teams concluded that, in general, the provisions of the Export Administration Act, as clarified by Executive Order 12981, are consistent and unambiguous. However, the Commerce and Defense IG teams stressed that the dual-use licensing process would be best served if the Export Administration Act were reenacted rather than to continue to operate under a patchwork of other laws and executive orders. Overall, the Arms Export Control Act is also consistent and unambiguous. Likewise, Executive Order 12981 is generally consistent with the Export Administration Act. However, the Executive Order needs modification to reflect the merger of the Arms Control and Disarmament Agency with the Department of State and to clarify representation at the Advisory Committee on Export Policy. In addition, policy and regulations regarding the export licensing requirements for items and information "deemed to be exports" needs clarification, and the exporter appeals process should be formalized.

The second area pertains to procedures used in the export license review processes. The Commerce, Defense, Energy and State IG teams concluded that processes for the referral of dual-use license applications and interagency dispute resolution

were adequate. Officials from those Departments likewise were generally satisfied with the 30-day time limit for agency reviews under Executive Order 12981; however, not every agency could meet that limit. Several Defense Components and the Central Intelligence Agency indicated they would benefit from additional time to review dual-use export license applications. The Defense and State IG teams were satisfied with the referral of munitions license cases for review; however, the Commerce IG team believed that inclusion of the Department of Commerce in the munitions case referral process should be considered. The Commerce commodity classification process could benefit from additional input on munitions-related items from the Departments of Defense and State. Also, Energy officials believed a more formal review process for munitions was needed, as the officials were unclear on their role in the current process.

The third area pertains to the cumulative effect of multiple exports to individual foreign countries. The U.S. Government lacked an overall mechanism for conducting cumulative effect analysis. However, some of the agencies involved in the export licensing process performed limited cumulative effect analyses, with the degree of analyses performed varying across the agencies. The Commerce, Defense, Energy and State IG teams

concluded that additional cumulative effect analysis would benefit the license application review process.

The fourth area relates to information management. The Commerce, Defense and State IG teams questioned the adequacy of the automated information systems that their Departments use to support license application reviews. Specifically, there were shortfalls in data quality, system interfaces, and modernization efforts. The audit trails provided by most of the respective export licensing automated data bases were adequate, but Defense procedures did not ensure that final Defense positions were accurately recorded. The Central Intelligence Agency IG team reported unsatisfactory documentation of end-user checks on munitions license applications.

The fifth set of issues concerns guidance, training and undue pressure on case analysts. The review indicated that Defense, Energy and State licensing officials had adequate guidance to perform their mission; however, Department of Commerce licensing officers and Central Intelligence Agency licensing analysts could benefit from additional guidance. On-the-job training was the primary training available at the Departments of Commerce, Defense, Energy, and State for licensing officers. The Commerce, Defense and State IG teams identified a need for a

standardized training program in their agencies. With very few exceptions, Commerce and Defense licensing officials reported they were not pressured to change recommendations on license applications. No Energy or State export licensing officials indicated they were pressured regarding their recommendations.

The sixth area regards monitoring compliance and end-use checks. The Department of Commerce did not adequately monitor reports from exporters on shipments made against licenses, and the Department of State's end-use checking program could be improved. The Departments of Commerce and State still use foreign nationals to conduct an unknown number of end-use checks; however, the Commerce IG team found that most end-use checks were being conducted by U.S. and Foreign Commercial Service officers or Commerce enforcement agents and the State IG team concluded it may be appropriate to use foreign nationals to do the checks under certain conditions.

The seventh area pertains to export controls enforcement. The Treasury IG team determined that, although Customs Service export enforcement efforts have produced results, the Customs Service is hindered by current statutory and regulatory reporting provisions for exporters and carriers. The Treasury

IG team also identified classified operational weaknesses in Custom's export enforcement efforts.

Recommendations and Other Reports

The IG teams made specific recommendations relevant to their own agencies. Those recommendations and management comments are included in the separate reports issued by each office, which are in Appendix C (Commerce), Appendix D (Defense), Appendix E (Energy), Appendix F (State), Appendix G (Treasury), and Appendix H (Central Intelligence Agency) of the interagency report. Appendixes D, E, and F are in Volume II. Appendixes G and H, which are classified, are in Volume III. Because of time constraints and the fact that there are no additional recommendations in the interagency report, management was not asked to respond separately to it.

Department of Defense Export Licensing Issues

Now I would like to change focus from the interagency report to the report issued by my office on Defense participation in the export control processes. Again, I would like to emphasize that our objective was to review the export licensing process and not to assess the appropriateness of individual license

applications. To summarize the results of the Defense IG team's review, I will address each of the 14 issues that Chairman Thompson posed in his August 1998 letter.

Issue 1. Examine whether the current, relevant legislative authority contains inconsistencies or ambiguities regarding the licensing of dual-use and munitions commodities, and the effect of any such inconsistencies and ambiguities.

Conclusion: The general nature of the Export Administration Act and the Arms Export Control Act creates a broad framework, but we found no inconsistencies or ambiguities in either law. The Acts give Federal departments and agencies flexibility to change details regarding the components of the dual-use commodities and munitions export licensing processes, without requiring frequent changes to legislation. We also concluded that the dual-use licensing process would be best served through reenactment of the Export Administration Act.

Issue 2: Examine whether Executive Order 12981 (1995) as implemented is consistent with the objectives of the Export Administration Act and other relevant legislative authority.

Conclusion: Executive Order 12981, as implemented, is generally consistent with the relevant objectives of the Export Administration Act, the principal legislative authority that we considered under this question. However, Executive Order 12981 decreased from 40 to 30 days the time that the Department has to review dual-use license applications. As a result of the shortened review period, the ability to locate the information necessary to inject into the license review process may have been diminished. However, it is difficult to measure the effect the decreased review time has had on the Department's review of dual-use license applications.

Issue 3: Determine whether there is a continued lack of interagency accord, as stated in the 1993 interagency report, regarding whether the Department of Commerce is properly referring export license applications (including supporting documentation) out for review by the other agencies.

Conclusion: Defense officials expressed general satisfaction with the dual-use export license applications that Commerce referred for review, although Defense officials disagreed with Commerce's decision not to refer 5 of 60 sampled dual-use license applications. They also expressed concern that Commerce referred too few commodity classification requests to

Defense for review. As a result, in some cases, Commerce made decisions on license applications with national security implications without the benefit of Defense input.

Issue 4: Determine whether the interagency dispute resolution (or "escalation") process for appealing disputed license applications allows officials from dissenting agencies a meaningful opportunity to seek review of such applications, and assess why this process is so seldom used.

Conclusion: With one possible exception, the interagency escalation process provided Defense a meaningful opportunity to appeal disputed dual-use license applications, although the outcome of the process often favored the Commerce position. The number of applications appealed to the Advisory Committee on Export Policy decreased as a result of Executive Order 12981, and Defense elected not to escalate disputed dual-use applications for a variety of reasons. Defense officials stated the, in general, decisions about escalating cases were made on the basis of the substance of the case, the viewpoints expressed by Department principals and the likelihood of prevailing at the Advisory Committee on Export Policy. Disputes over munitions applications were resolved between office chiefs at Defense and State.

Issue 5: Review whether the current dual-use licensing process adequately takes into account the cumulative effect of technology transfers resulting from the export of dual-use items, and the decontrol of munitions commodities.

Conclusion: The licensing process at the Technology Security Directorate, Defense Threat Reduction Agency, occasionally takes into account the cumulative effect of technology transfers, but participants in the licensing process did not routinely analyze the cumulative effect of proposed exports or receive assessments to use during license reviews. In addition, Defense organizations did not conduct required annual assessments of the impact of technology transfers that could provide information on the cumulative effect of proposed exports. As a result, the Department cannot ensure that the licensing process takes into account the cumulative effect of technology transfers. As of March 1999, the Technology Security Directorate, Defense Threat Reduction Agency, had initiated actions designed to increase the degree to which cumulative effect analysis was incorporated into the licensing process, but the matter is still under review. We recognize that organizing and resourcing a meaningful cumulative effect analysis process

pose a significant challenge, but this is clearly an area that needs more emphasis.

Issue 6: Review whether the current munitions licensing process adequately takes into account the cumulative effect of technology transfers resulting from the export of dual-use items, and the decontrol of munitions commodities.

Conclusion: The observations made on Issue 5 also apply to the munitions licensing process.

Issue 7: Determine whether license applications are being properly referred for comment (with sufficient time for responsible review) to the military services, the intelligence community, and other relevant groups (the "recipient groups") by Defense and other agencies. Consider in particular numerical trends in the frequency of such referrals, trends in the type of applications referred, trends in the nature of the taskings made in connection with the referrals, and the perceptions of officials at the recipient groups.

Conclusion: The Defense Components, except the Defense Intelligence Agency, have received about the same number of case referrals annually over the past 8 years. However, the

Technology Security Directorate, Defense Threat Reduction Agency, did not always appropriately refer license applications to other Components for review. Of the applications we reviewed, various Components considered that 12 percent of the dual-use and 24 percent of the munitions license applications were not properly referred. If the Technology Security Directorate, Defense Threat Reduction Agency, does not properly refer a case to other knowledgeable Component for review, the Department's position may be developed with incomplete information.

Issue 8: Determine whether license review officials at each of the agencies are provided sufficient training and guidance relevant for reviewing license applications, and whether more formal training and guidance is warranted.

Conclusion: The Technology Security Directorate, Defense Threat Reduction Agency, and other Defense organizations involved in the review processes received appropriate guidance from a range of sources, and nearly all licensing officers stated the guidance was adequate for performing their duties. Licensing officers also stated that they generally had sufficient training; however, some licensing officials believed that a classroom training program and training plan for

personnel reviewing export license applications should be established. We were unable to determine if the lack of a classroom training program or a training plan has materially affected licensing duties, but we concluded that putting more emphasis on training would be prudent.

Issue 9: Review the adequacy of the databases used in the licensing process, such as the Defense Foreign Disclosure and Technical Information System [FORDTIS] paying particular attention to whether such databases contain complete, accurate, consistent, and secure information about dual-use and munitions export applications.

Conclusion: FORDTIS provides a useful communication and coordination mechanism for the Department on export control matters, although limitations existed in the system that reduced the support provided to decisionmakers. In addition, as will be discussed in our response to Issue 13, inadequacies existed in the use of FORDTIS to provide an audit trail for export licensing decisions.

Issue 10: In congressional testimony, a Defense licensing officer described instances where licensing recommendations he entered on FORDTIS were later changed without his consent or

knowledge. Examine those charges, and assess whether such problems exist at your agencies.

Conclusion: Instances occurred in which recommended positions entered in FORDTIS by a licensing officer were changed without the consent or knowledge of that officer, although the number of such occurrences could not be determined. These changes appear to have been based on supervisors' disagreements with the licensing officers conclusions. Such changes are permissible under Department policy. In addition, documentation related to the changes was not always complete.

Issue 11: Determine whether license review officials are being pressured improperly by their superiors to issue or change specific recommendations on license applications.

Conclusion: We interviewed all Defense Threat Reduction Agency licensing officers and, with one exception, they indicated to us that they had not been subjected to any improper pressure to change specific recommendations on license applications. Other staff at the Technology Security Directorate, Defense Threat Reduction Agency, who did not formulate proposed recommendations on license applications, but who were at times involved with reviewing or processing license

applications, also did not report any improper pressure directed at them to change positions on specific license applications. However, several of the Technology Security Directorate staff members stated that management applied indirect pressure to encourage certain viewpoints. We are aware that at least one licensing officer has alleged retaliation by management for disclosing problems in the licensing review process.

Issue 12: Determine whether our Government still uses foreign nationals to conduct pre-license or post-shipment licensing activities and whether such a practice is advisable.

Conclusion: In general, Commerce and State conduct pre-license and post-shipment licensing activities. Defense provides limited support to Commerce and State pre-license and post-shipment licensing activities through Defense Attaché' Offices. Defense also supports State by monitoring certain foreign space launch activities under the provisions of munitions licenses. Defense has not used and does not plan to use foreign nationals to support Commerce or State pre-license and post-shipment licensing checks or to monitor space launches.

Issue 13: Determine whether the agency licensing process leaves a reliable audit trail for assessing licensing performance.

Conclusion: FORDTIS provided a long-term audit trail for positions on license reviews, but it did not always contain complete and accurate records of Defense and U.S. Government positions. The audit trail provided by FORDTIS for the sample reviewed generally agreed with the Commerce electronic records. However, in one instance the Commerce records showed a change to the conditional license approval from Defense that was not shown in FORDTIS. In another instance, a conditional approval recommended by Defense for a license application was not included in the Commerce record. In addition, the audit trail provided by FORDTIS did not include new information presented at interagency decision meetings, detailed results of those meetings, records of all applications referred to the National Security Agency, as well as key correspondence or technical data. As a result, the audit trail provided by FORDTIS cannot be used as a reliable means of assessing the degree to which overall Defense positions were in agreement with positions taken by the U.S. Government.

Issue 14: Describe the procedures used by agencies to ensure compliance with conditions placed on export licenses (for example, no retransfers without U.S. consent, no replications,

and peaceful use assurances) and assess the adequacy and effectiveness of such procedures.

Conclusion: The Department has a limited formal role in ensuring compliance with conditions placed on export licenses. In its support to State, the Technology Security Directorate, Defense Threat Reduction Agency, had adequate procedures for monitoring foreign space launch activities. Its informal process for reporting potential violations of license conditions and technology assessment control plans was also adequate. However, expected increases in the number of launch monitoring missions coupled with a programmed increase in staff to support these missions dictates the Department move to a more formal approach to reporting violations. If not, the informality of the current reporting process could fail to ensure that State receives the highest quality of reporting from Defense.

Recommendations

We made a number of recommendations to the Department to improve the effectiveness and efficiency of export licensing review efforts, as follows:

- The Under Secretary of Defense for Policy should revise Defense Directive 2040.2 to clearly state responsibilities and procedures regarding the performance of assessments designed to analyze the cumulative effect of technology transfers and the monitoring of compliance with any requirements established and to obtain FORDTIS access for country desk officers reviewing export license applications.

- The Director, Defense Threat Reduction Agency, should develop an agency-wide training policy, training plan, and a classroom training program for Defense Threat Reduction Agency licensing officers; provide other Defense Components the classroom training program for licensing officers; and, in coordination with the Department of State, develop and implement a memorandum of understanding on reporting requirements for the Space Launch Safeguards and Monitoring Program.

- The Director, Technology Security Directorate, Defense Threat Reduction Agency, should work with the Assistant Secretary of Commerce for Export Administration to develop additional guidance and procedures on how to implement 1996 National Security Council guidance on commodity

jurisdiction and commodity classification; develop an action plan with milestones for the integrated process team on the Militarily Critical Technologies Program that includes defining a process for identifying, prioritizing, and obtaining decisions on assessments related to the cumulative effect of technology transfers; reiterate his request that the Defense Components identify the types of licenses they would like to review; notify the Assistant Secretary of Defense (Strategy and Threat Reduction) of any Defense Component that does not identify the cases it wants to review; maintain a list of the types of export license applications that Defense Components have requested to review; establish procedures to ensure adequate documentation of changes to the position of a licensing officer; and establish procedures to ensure that FORDTIS records include the correct Defense position, additional information presented at the Operating Committee, an explanation of why Defense did not escalate disputed cases, the results of encryption cases referred to the National Security Agency, and key correspondence and technical data.

The Deputy Under Secretary of Defense (Policy Support) should provide guidance to Defense Components on how to query FORDTIS in order to generate dual-use and munitions

reports; monitor modernization efforts of Commerce's export control information systems; and ensure that initiatives on electronic imaging in support of the export review process are successfully implemented within Defense.

Management Response

The Principal Deputy Under Secretary of Defense for Policy provided comments on our draft report that were generally responsive to the findings and recommendations. We made relatively minor adjustments in the final report, based on those comments, and have requested the Department to provide additional comments to clarify what corrective actions are going to be taken on a few specific items. We will track the progress of all agreed-upon actions through our audit followup procedures.

Conclusion

In conclusion, Mr. Chairman, we hope that this extensive multi-agency review will be useful to both the involved agencies and the Congress as efforts to update and improve U.S. export licensing practices continue. I would be remiss if I did not make a point of noting, in closing, that we received excellent cooperation from agency personnel at all levels during this review.

This concludes my statement.

UNITED STATES DEPARTMENT OF COMMERCE
The Inspector General
Washington, D.C. 20230

STATEMENT BY

JOHNNIE E. FRAZIER

ACTING INSPECTOR GENERAL

U.S. DEPARTMENT OF COMMERCE

BEFORE THE

COMMITTEE ON GOVERNMENTAL AFFAIRS

UNITED STATES SENATE

JUNE 23, 1999

Mr. Chairman and Members of the Committee, I am pleased to appear before you today to discuss the Commerce Office of Inspector General's (OIG) review of the Department of Commerce's export licensing process for dual-use commodities. In August 1998, you requested that the Inspectors General from the Departments of Commerce, Defense, Energy, State, the Treasury, and the Central Intelligence Agency conduct an interagency review of the export licensing process for dual-use commodities and munitions. Specifically, you asked the six Inspectors General to update a 1993 special interagency OIG review of the export licensing process and to answer 14 questions. In response to your request, we conducted a program evaluation of the Department's export licensing process, focusing on the effectiveness of the current policies, procedures, and practices in its licensing of dual-use goods and technologies.

The Department of Commerce's Bureau of Export Administration (BXA) administers the U.S. government's export control licensing and enforcement system for dual-use commodities for national security, foreign policy, and nonproliferation reasons. Dual-use commodities are goods and technology determined to have both civilian and military uses. BXA controls dual-use exports under the authority of several laws, including the Export Administration Act of 1979, as amended. Since that statute expired in September 1990,[1] Presidents Bush and Clinton have extended existing export controls by executive order, invoking emergency authority contained in the International Emergency Economic Powers Act of 1977, as amended. These controls continue in effect today through Executive Orders 12924 and 12981.

Our review found that the multi-agency process for licensing U.S. dual-use exports is generally effective in bringing divergent policy views and information to bear on decision-making for export licenses (see Exhibit 1). That process includes not just the Commerce Department, but also the Departments of Defense, Energy, State, Justice (for encryption exports), the U.S. Arms Control and Disarmament Agency (ACDA),[2] and the Central Intelligence Agency's Nonproliferation Center. Under Executive Order 12981, these agencies have the authority to review all dual-use export license applications submitted to Commerce. The executive order also established mandatory escalation procedures to be followed when Commerce and the referral agencies disagree about dual-use export license applications and refined the time lines for this process.

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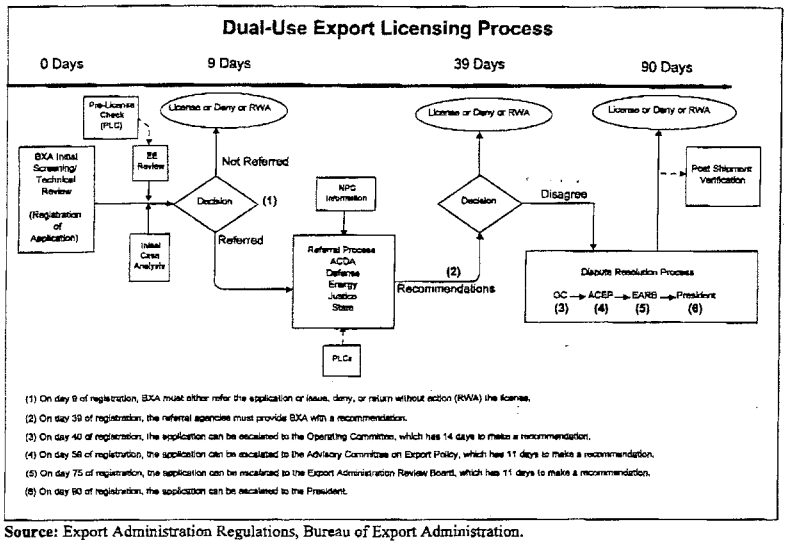
[1]Except for a brief time period in 1994, when the Act was temporarily extended by the Congress.

[2]ACDA was a separate agency until April 1999, when it became a part of the Department of State.

Exhibit 1



Source: Export Administration Regulations, Bureau of Export Administration.

We determined that the interagency export license referral and escalation processes are working reasonably well. There are four levels of escalation for dual-use cases: the Operating Committee (OC) at the senior civil service level, the Advisory Committee on Export Policy (ACEP) at the assistant secretary level, the Export Administration Review Board (EARB) at the Cabinet level, and the President. Each level of the escalation process is required to consider all matters referred to it, giving consideration to national security, foreign policy, and proliferation of weapons of mass destruction. With an orderly procedure to resolve interagency disputes in place

since 1995, the export licensing process has been greatly improved since the 1993 special interagency OIG review.

While we noted significant areas of improvement since our 1993 review, we also identified a number of problems that warrant the attention of the Department, the Administration, and the Congress.

I. EXPORT CONTROL LEGISLATION AND REGULATIONS

The 1990s have brought dramatic changes in worldwide economic and political conditions, as well as in the environment for controlling the export of U.S. commodities and technology. As we examined the legislation, executive orders, and regulations used to control U.S. exports, we found several legislative and regulatory weaknesses that need to be addressed in order to strengthen the export control process.

Export Administration Act of 1979. First and foremost, new legislation is needed to replace the expired Export Administration Act and accurately reflect current export control policies. Since early 1990, both the Congress and the Administration have tried to rewrite the basic law that authorizes the President to regulate exports from the United States. It is time to push even harder for new legislation, since the current emergency powers authority does not provide for strong penalties for those who violate U.S. export controls. In addition, as the United States encourages other countries, such as those in Eastern Europe and Southeast Asia, to implement export controls, we must set the example by sending a clear signal that we are committed to such

controls. The fact that it has been so long since the expiration of the Act potentially sends a message to other countries, including our allies, that the United States is not truly committed to export controls. Thus, I strongly urge the Congress and this Committee to push for passage of new legislative authority for dual-use export controls. In the new legislation, we recommend that the Congress maintain the transparency provided for in the executive order and continue to give all licensing agencies the authority to review all export license applications. In addition, the Congress should maintain the dispute resolution process outlined by Executive Order 12981.

Deemed Exports. The export licensing policy and regulations regarding the release of certain technology or software to foreign nationals–commonly referred to as "deemed exports"–are ambiguous and need to be revised. Deemed export license applications made up approximately 10 percent of the 11,015 export license applications processed by BXA in fiscal year 1998. However, one BXA official estimated that 25 U.S. companies submit most of the deemed export applications that BXA processes. In addition, BXA received only two export license applications from Energy's research laboratories in fiscal year 1998. While BXA has done some outreach, it appears that there is a general lack of knowledge and understanding on the part of U.S. industry and the federal laboratories about the deemed export regulations and when an export license is required. Thus, our report urges BXA to move expeditiously to clarify this requirement with the National Security Council and provide clearer guidance to U.S. research laboratories and industry to preclude the release of sensitive technology to inappropriate end users.

National Defense Authorization Act for FY 1998. The National Defense Authorization Act for fiscal year 1998 requires exporters to notify BXA of their intent to export or reexport high performance computers, or HPCs, with a performance capability of between 2,000 and 7,000 Million Theoretical Operations Per Second (MTOPS) to Tier 3 countries, such as China, Israel, and Russia. We believe that this reporting requirement is reasonable and helps the U.S. government to monitor these shipments.

However, the Act's requirement that a post shipment verification be conducted for every HPC greater than 2000 MTOPS that is shipped to Tier 3 countries may not be the most effective use of government resources. Specifically, the Act requires that a U.S. government employee visit all high performance end users even if they have been visited in the recent past, to judge whether their U.S. computers are being used for weapons development. As a result, it has forced BXA to divert some of its enforcement resources to the conduct of Post Shipment Verifications on lower end HPCs or on multiple visits to the same end users that could have otherwise been used for targeting end use checks on the HPC shipments of greater concern or on other critical commodities and technologies. Thus, while we believe that exporter shipment reporting and end user checks on HPCs are important export controls, we recommend that some modification to the current Post Shipment Verification requirement be seriously considered.

II. COMMODITY CLASSIFICATION PROCESS

While BXA holds the exporter responsible for following export regulations and properly classifying an export item, it will advise an exporter on whether an item is subject to the Export Administration Regulations and, if applicable, identify the appropriate Export Control Classification Number. Exporters may verbally inquire about a commodity classification, or CCATS, but only written inquiries result in binding determinations by BXA. During our review, we were pleased to note that BXA had instituted a front-end review mechanism to pre-screen commodity classifications to ensure that the appropriate licensing engineer reviews the applicable CCATS.

While this initial step serves as an important quality control measure, our review identified two areas in the commodity classification process that still need improvement. First, BXA needs to improve the timeliness of its processing of exporters' commodity classification requests. Instead of meeting the required 14-day deadline for CCATS reviews, BXA took 37 days, on average, to process CCATS determinations in fiscal year 1998. This has resulted in delays for exporters.

Second, and more importantly, BXA needs to work with both Defense and State to ensure that the CCATS process is more transparent, or open and clear to all parties, with regard to items or technologies specifically designed, developed, configured, adapted, and modified for a military application, or derived from such items as called for in the 1996 National Security Council guidance. Specifically, while there were 2,723 CCATS requests in fiscal year 1998 alone, BXA has only referred 27 CCATS to the State Department since 1996 and only 12 completed CCATS

determinations were sent to the Defense Department. Both departments complained to us during this review about BXA not adequately coordinating the CCATS process with them.

As part of our review, we sought to determine whether past commodity classification determinations by BXA did, in fact, support the concerns of Defense and State about the accuracy of Commerce's CCATS decisions. We invited analysts from Defense and State to review a sample of commodity classification line items and second-guess the original determinations made by BXA.[3] Based on our sample of 103 CCATS, we determined that 2 of these requests should have been referred to State for review. In addition, there was disagreement on three additional cases in which Defense agreed that the items fell under the Commerce Control List but disagreed on the export control classification number.

Thus, while our CCATS review showed interagency disagreement on very few cases, it did show clearly that the CCATS process was not transparent and that BXA was not complying with the National Security Council guidance to refer defense-related CCATS to Defense and State. Therefore, we recommended that BXA, in conjunction with Defense and State, work with the National Security Council to develop specific criteria and procedures for the referral of munitions-related commodity classifications to Defense and State to ensure that those agencies are involved in the CCATS process.

[3]Officials from the Department of State's Defense Trade Controls chose not to participate in the review.

III. GUIDANCE, TRAINING, AND INDEPENDENCE ISSUES

Licensing Officer Guidance. Our review disclosed that the policy and procedures used by BXA licensing officers to process export license applications varied. Many licensing officers who responded to our survey questionnaire, as well as those we interviewed throughout the review, identified the lack of up-to-date guidelines as one of BXA's major weaknesses. We were pleased to see that near the end of our review, on March 31, 1999, BXA officials implemented new procedures to improve licensing officer guidance. The new guidelines emphasize the importance of a licensing officer obtaining sufficient information before making a recommendation on a case and documenting all relevant facts and details pertaining to it. We determined that the new guidance for licensing officer case analysis is more thorough. However, our report details some additional steps that we think BXA can take to further strengthen the support and guidance available to its licensing officers as they complete their reviews of license applications.

Training. We also found training provided to licensing officers to be inconsistent and often unresponsive to their needs. The export licensing function requires a continuous structured training program to ensure that the licensing officers' critical thinking and knowledge of export control issues and concerns are as strong as possible.

We were particularly concerned about the adequacy of training for new licensing officers. Such training is generally left up to the individual licensing divisions and mostly consists of reading the Export Administration Regulations and learning on-the-job primarily by directing questions

to more experienced staff. By contrast, we found that BXA's Encryption Policy Division provides a comprehensive training program for all of its new analysts. Specifically, new analysts (1) spend three weeks answering phones and sitting in on other calls in the Exporter Counseling Division, (2) observe the division director's telephone responses to exporter questions, (3) attend seminars on regulations and specific technologies sponsored by BXA for exporters, and (4) observe interagency working group and industry meetings.

While we recognize that training needs to be flexible to allow for different learning methods in a variety of disciplines, we recommended that BXA consider using this kind of training program for all new licensing officers. We also recommended that BXA identify and prioritize the current and future learning needs of its licensing officers and then establish a formal training program to meet those needs. Our report offers a number of suggestions for in-house and outside training, as well as for interagency exchanges of personnel, that we believe would further improve licensing officers' performance.

Pressure on Licensing Officials. Our survey results indicated that most BXA licensing officials are not pressured into changing their positions on specific license recommendations. While 2 of the 36 licensing officials who responded to this specific survey question indicated that they had received some pressure from management to change positions on recommendations,[4] the remaining licensing officer responses to the survey, as well as our

[4]During our detailed follow-up interview with one of the licensing officials, he was unable to provide any details, or specifics about being pressured. While the second response was sent anonymously, we found no evidence to support this individual's statement.

interviews with BXA personnel, did not indicate pressure had been exerted on licensing officials to unduly influence their licensing recommendations.

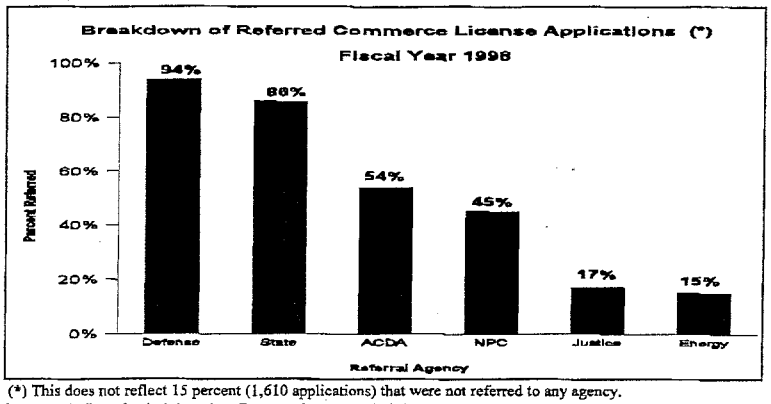
However, a third survey respondent, who is also the Chair of the Operating Committee, indicated that upper management sometimes conveys instructions about the decision she should make on a specific OC case. She indicated that this is a rare occurrence and that it generally involves a situation where she believes more information is needed about the transaction before a final decision can be made, and not necessarily a decision that she would ultimately disagree with if she had more time to consider the case. While we understand that the OC Chair is a BXA employee and that the Executive Order recognizes that an OC decision is a Commerce decision that can be escalated by a dissenting member agency, we also believe that one could interpret the role of the OC Chair, as being "independent." The Executive Order procedures call for the Chair to preside over the OC meeting and listen to all of the reviewing agency arguments–including BXA's–before rendering a decision on a case.

As we outline in our report, we believe that the OC Chair should be free to independently decide a case, and we advised BXA management that it should definitely not give the impression that it is instructing the Chair on what licensing decisions to make. If the Chair makes a decision that BXA disagrees with, BXA should use the avenue afforded it under the executive order to escalate cases to the Advisory Committee for Export Policy in order to avoid any misconceptions or even the appearance that this part of the process is not transparent.

IV. EXPORT LICENSE APPLICATION REFERRAL PROCESS

As I stated earlier, the licensing review and referral process for dual-use commodities has improved since the last OIG review in 1993. In fiscal year 1998, BXA referred 85 percent of export license applications to other agencies for review, up from 53 percent in fiscal year 1993, (see Exhibit 2). While we believe the overall referral process is generally more effective because of greater interagency involvement, we did identify some problems that need improvement and management attention. We are concerned about (1) licensing officers amending some existing licenses without interagency review; (2) inadequate review time being provided to the CIA's Nonproliferation Center for its end user checks; (3) BXA canceling some pre-license checks without notifying the referral agencies when they have approved a license conditioned on a favorable end use check; and (4) BXA's returning some export license applications without action after unfavorable pre-license checks are received. BXA management, in response to our report, has agreed to correct or address most of these problems. In addition, we identified two other problems that require interagency action and attention by the Congress.

Exhibit 2



(*) This does not reflect 15 percent (1,610 applications) that were not referred to any agency.
Source: Office of Administration, Bureau of Export Administration.

Intelligence Agencies' Involvement in License Review. First, while the intelligence community plays a critical role in license review and threat analysis, we found that the CIA and its Nonproliferation Center, at their own request, review only 45 percent of all dual-use export applications. In addition, they do not always conduct a comprehensive analysis of the export license applications they do receive. Furthermore, the current dual-use licensing process does not take into account the cumulative effect of technology transfers. While individual technology sales may appear benign, the piecing together of these sales over a long period of time from many sources may allow U.S. adversaries to incrementally build weapons of mass destruction or other capabilities that could threaten our national security. We believe this cumulative effect

analysis–while difficult to make–would be valuable to have during the export license application decision-making process.

In addition, since cumulative effect results not only from the transfer of items under approved export licenses from the United States, but also from the provision of items not requiring a license and shipments from foreign suppliers as well as indigenous resources and capabilities, BXA suggested that any assessment of cumulative effect be made during the multilateral list review process (e.g., Wassenaar Arrangement) instead of on each individual license application. We agree that this type of assessment during the list review process could also be advantageous.

Screening BXA License Data Against Customs' TECS Database. Second, as we have reported several times in the past, another key element missing from the export licensing process is the screening of all parties to pending license applications against the Treasury Enforcement Communications System, or TECS, database maintained by the Treasury Department's U.S. Customs Service. TECS was created to provide multi-agency access to a common database of enforcement data developed through the sharing of sensitive information between federal law enforcement agencies. Screening every export license applicant and consignee against TECS during the initial phases of the licensing process would give licensing and enforcement authorities early warning of any potential concerns Customs may have and would ensure that BXA consider all potential U.S. export enforcement concerns before issuing a license. By not doing so, BXA is making licensing decisions based on incomplete information. As a result, we

again recommend that BXA reach an agreement with Customs to provide for TECS screening of pending license applications.

V. DISPUTE RESOLUTION PROCESS

We believe that the current four-level dispute resolution process has been effective. We found that the process gives officials from dissenting agencies a meaningful opportunity to seek additional review of disputed cases. From fiscal years 1991 to 1998, the number of cases escalated to the Operating Committee increased by 353 percent, while the number of cases escalated to the Advisory Committee on Export Policy decreased by 62 percent. In addition, only 21 license applications have been escalated to the Export Administration Review Board during this time period; of which only one of those has been escalated since 1991 (see Exhibit 3). Most of the cases in dispute have been resolved at the working level interagency Operating Committee. We attended a number of the OC and ACEP meetings and were impressed with the level of discussion and technical details that the members dealt with to resolve their questions about specific license applications and potential end users.

Exhibit 3: Number of Export License Applications Escalated Fiscal Years 1991 - 1998

Fiscal Year	Export License Applications Received	OC	ACEP	EARB
1991	33,118	169	89	20
1992	24,071	333	105	0
1993	26,125	493	142	0
1994	12,609	281	97	0
1995	9,988	161	68	0
1996	8,710	435	71	0
1997	11,480	784	38	1*
1998	10,696	766	34	0

*** Although this case was escalated to the EARB, the EARB was never convened. Subsequently, the final vote on this case defaulted to the ACEP majority vote of approval with conditions.**

Source: Office of Administration, Bureau of Export Administration.

We found that the Chair of the Operating Committee affords each agency–including BXA–the opportunity to present its recommendation on every application the Committee reviews. The OC Chair has the authority to decide all cases at this level without having to reflect the recommendations of the majority of the participating agencies. However, we found that the decisions of the Chair are usually based on interagency consensus, which is built through healthy exchanges and debate, often resulting in special conditions being added to a license before approval. In addition, if any agency does not agree with the Chair's decision to approve or deny, it can independently escalate the decision to the ACEP. While we concluded that the OC is working well, we did identify several areas that need management attention: (1) the OC Chair's

independence needs to be clarified, as I discussed earlier, and (2) the process of returning escalated cases to the licensing officers requires additional quality control.

VI. EXPORTER APPEALS PROCESS

Once an export license application has been formally denied, the exporter has the right to appeal to the Under Secretary of Commerce for Export Administration, whose decision is considered final. Although BXA confers informally with the referral agencies before deciding on appeals, there is no requirement that this decision be made in consultation with the other referral agencies involved in the export licensing process. While we found no evidence to suggest that exporters are using the appeals process to circumvent the interagency referral process, we believe that the referral agencies should be formally included in the appeals process. We made this recommendation to BXA, and it has agreed to work with the National Security Council to formalize the appeals process. We also would recommend that the Congress include a formal interagency appeals process in the new Export Administration Act.

VII. MONITORING LICENSE CONDITIONS

The ability to place conditions on a license is an important part of the license resolution process, as well as an additional means to monitor certain shipments. Frequently, the conditions are the result of lengthy negotiations among Commerce and the referral agencies. While 28 standard conditions can be placed on an export license, there are only 7 that actually require the exporter to provide documentation to BXA for shipments made against the license. We found that BXA

is still not adequately monitoring license conditions as first reported in the 1993 special interagency OIG review.

Specifically, we determined that BXA's follow-up systems were out of date and that the two offices responsible for following up on licenses did not give sufficient priority to determining whether exporters had complied with the reporting conditions. In addition, most licensing officers (except for those responsible for deemed exports and encryption) are not involved in monitoring conditions they place on the licenses. Licensing officers also did not have access to exporters' compliance history in order to make the most informed decision about an export license application. By not having an adequate monitoring system in place, BXA cannot assure itself that the goods were not diverted to an unauthorized end user, and exporters may receive new licenses even if they did not comply with previous licenses. We recommended that BXA improve its follow-up with exporters to determine if shipments were made against licenses, including periodically performing a random spot-check on licenses to monitor exporter compliance with license conditions.

VIII. END USE CHECKS

End use checks are an important part of the license evaluation process because they verify the legitimacy of export transactions controlled by BXA. A pre-license check is used to validate information on export license applications by determining if an overseas person or firm is a suitable party to a transaction involving controlled U.S.-origin goods or technical data. Post shipment verifications strengthen assurances that exporters, shippers, consignees, and end users

comply with the terms of export licenses and licensing conditions, by determining whether goods exported from the United States were actually received by the party named on the license and are being used in accordance with the license provisions. These checks, which help prevent and detect illegal technology transfer, are generally conducted by Commerce's U.S. and Foreign Commercial Service (US&FCS) officers stationed at overseas diplomatic posts and by BXA's export enforcement agents through its Safeguard Verification program.

During this review we found some of the same problems identified in our previous reviews with respect to end use checks conducted by US&FCS. Among these concerns are (1) untimely end use checks, (2) US&FCS's use of foreign service nationals and personal services contractors to conduct some checks (see Exhibit 4), (3) failure to always perform on-site checks, and (4) insufficient US&FCS coordination with other parts of the embassy and host governments in conducting checks.

Exhibit 4

	US&FCS Checks Reviewed	US&FCS Personnel Conducting End Use Checks			
		Officer	FSN/PSC	Combination	Unclear
PLC	90	22	5	36	27
PSV	15	10	0	0	5
Total	105	32	5	36	32

Notes: PLC= pre-license check, PSV= post shipment verification, FSN= foreign service national, and PSC= personal services contractor

Source: Office of Enforcement Analysis, Bureau of Export Administration.

In addition, while we found that Export Enforcement's Safeguard Verification program enhances the quality of end use checks because of the "enforcement" element it brings to the process, we made a number of suggestions to make this program more effective, including: (1) better initial trip planning, (2) additional in-country consultations, (3) clearer guidance or a standard format for trip reports, and (4) faster and wider dissemination of Safeguard check results, especially negative findings. We also believe that BXA should use the Safeguard visits as an opportunity to provide additional training for US&FCS staff on conducting end use checks.

IX. BXA'S AUTOMATED EXPORT LICENSING SYSTEM

BXA's automated export licensing system, called ECASS,[5] was developed in 1984. It is a large database system that provides license processing and historical license information to BXA and the referral agencies. We determined that the system's internal controls are generally adequate and that its data are sufficiently reliable. In answer to one of your specific questions, we also determined that licensing recommendations or decisions entered into the database could not be changed without the knowledge of the licensing officer.

At the same time, it is readily apparent that BXA's automated information system needs to be replaced. The system is still supporting the licensing process, but we believe that it is inefficient and outdated. ECASS lacks good query capabilities, expanded text capabilities, modern interfaces, and online access to exporters' technical specifications. We strongly agree with BXA

[5]Export Control Automated Support System

that it needs a new system to process export license applications efficiently and effectively. We endorse BXA's efforts to work with the Department, OMB, and the Congress to secure funding for the development of a new system as soon as possible. We have recommended that BXA consider the best available system replacement options, including a classified system. A classified system would enable BXA's licensing officers to have online access to classified data needed to process applications more efficiently, as well as make it easier to interface with the referral agencies that use a classified system. We also have urged BXA to coordinate its system development efforts with the other export licensing agencies to ensure that all of their export control systems are compatible and, at a minimum, are able to interact with each other.

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This concludes my statement Mr. Chairman. I would be pleased to answer any questions you or other Members of the Committee may have.

STATEMENT OF
JOHN C. PAYNE
DEPUTY INSPECTOR GENERAL FOR THE
U.S. DEPARTMENT OF STATE, AND THE UNITED STATES INFORMATION AGENCY, INCLUDING INTERNATIONAL BROADCASTING

FOR THE

COMMITTEE ON GOVERNMENTAL AFFAIRS
U.S. SENATE

June 23, 1999

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to testify before your committee on the export licensing process for munitions and dual-use commodities. My testimony today is based on work we conducted in response to your August 1998 request to update and expand on the Office of Inspector General's (OIG's) 1993 interagency report related to export licensing. Our report answers the 14 questions you asked and discusses the Department of State's role in the interagency export licensing process for munitions and dual-use commodities.

SUMMARY

We found that, overall, the export licensing process is working as intended and the Department of State (State) consistently executed its export licensing responsibilities in accordance with established policies through its Office of Defense Trade Controls (DTC). In responding to your questions, we found no significant inconsistencies or ambiguities in the legislative authorities that guide the export licensing process. In addition, based on a valid statistical sample, we found that State consistently referred all appropriate munitions license applications to other agencies for review, and fully addressed the concerns raised. We found no evidence that State licensing officials had ever been improperly pressured by their superiors to approve license applications. Finally, we found that a reliable and adequate audit trail existed for both the processing of munitions and dual-use licenses at State.

However, our review identified areas for improvement, and recommended that State enhance the end-use monitoring program and expand training for licensing officers. Also, the current munitions and dual-use licensing processes do not fully measure the cumulative effect of technology transfers. Finally, a lack of resources negatively affects State's ability to fulfill its mandate.

End-use monitoring. DTC's formal process for conducting end-use checks is known as the Blue Lantern program. The program, which includes pre-license and post-shipment checks, was established in 1990 to verify the ultimate end use and end user of U.S. defense exports. Although DTC continues to refine its program, additional improvements can be made. For example, DTC should place more emphasis on the selection criteria used to initiate Blue Lantern checks. Second,

DTC should improve the timeliness of its end-use checks by more consistently monitoring and following up on its Blue Lantern requests. Finally, DTC should assist posts with appropriate expertise for technical on-site inspections.

Training for licensing officers. Licensing officers need additional training opportunities. DTC relies primarily on an apprenticeship approach and although this provides important hands-on training, there is no formal training available to provide new licensing officers with a broad overview of the export licensing process. Training for more senior licensing officers is limited, and they have little opportunity to participate in external training classes and industry outreach activities. Although we believe training should be improved, we did not identify any specific problems that resulted from a lack of training.

Cumulative effect of exports and technology transfers. The current munitions licensing process does not fully measure the cumulative effect of technology transfers resulting from the export of munitions items. DTC can improve its assessment of the cumulative effect by expanding the use of trend analyses and other reporting mechanisms. Nevertheless, DTC represents only one piece of a much larger picture. To assess the cumulative effect, information on technology transfers resulting from munitions and dual-use exports, foreign military sales, and third-country sales to foreign countries would need to be considered, as well as the internal capabilities of a specific country. A comprehensive assessment will probably require a joint effort with resources and coordination from various Federal departments and agencies involved in the licensing process.

Inadequate resources. Many of the concerns cited above are symptomatic of a larger problem at DTC -- insufficient resources to meet its expanding mandate. DTC has fewer employees and lower pay grades compared to other agencies involved in export licensing. DTC licensing officers have higher workloads and a lower journeyman grade level than their counterparts at the Department of Commerce (Commerce) and Department of Defense (Defense). In FY 1998, 16 DTC licensing officials processed 44,000 license applications, while at Commerce 47 licensing officials processed 13,500 applications. This has impeded DTC's ability to perform its munitions licensing responsibilities. The workload of licensing officers and the time needed to process licenses have increased, contributing to employee turnover and fewer training opportunities. The situation continues to worsen because DTC officially assumed responsibility for all commercial satellite cases from Commerce on March 31, 1999.

Recognizing the need for additional resources and the recent statutory change in commercial satellite responsibility, Congress recommended in the conference report accompanying the FY 1999 State Department appropriations bill, and in the conference report accompanying the emergency supplemental appropriations for FY 1999, that State provide DTC with a $2-million increase over its FY 1998 budget of $5,011,000, representing a 39 percent budget increase. Congress directed DTC to use this money to hire additional senior-level personnel at the GS 13-15 levels and support staff to improve the scrutiny of export license applications, enhance end-use monitoring, and strengthen compliance enforcement measures to ensure that U.S. technology is properly safeguarded when exported. State officials said that as of June 7, 1999, State increased DTC's budget by $2 million over FY 1998 funding levels. DTC plans to add a total of 23 positions, however, as of June 18, 1999, DTC had only received authorization to hire 8 additional staff persons.

BACKGROUND

The United States controls the export of defense articles and services on the U.S. Munitions List under the authority of several laws, chiefly the Arms Export Control Act of 1976 (AECA). The AECA authorizes the President to provide U.S. foreign policy advice to U.S. citizens involved in the manufacture, export, and temporary import of defense articles and services. The AECA also requires that licenses be obtained before defense articles or services are exported and that such articles and services be designated on the U.S. Munitions List. Executive Order 11958 delegates the responsibility for administering the functions of the AECA to the Secretary of State. Within State, DTC in the Bureau of Political-Military Affairs (PM) is responsible for administering these functions, among others, on a day-to-day basis. Munitions commodities are generally products that have been specifically designed for military application. They include products such as aircraft, tanks, and rifles and services such as assistance to foreign persons in the design, development, manufacture, or engineering of defense articles. In FY 1998, DTC processed over 44,000 munitions license applications.

Commerce is the agency responsible for licensing dual-use commodities, which are commercial commodities that also have military application. State reviews, for foreign policy considerations, dual-use license applications referred by Commerce. During FY 1998, State reviewed over 8,000 dual-use license applications. This represents 75 percent of all license applications received by Commerce. At State, three offices in the Bureau of Nonproliferation (NP) play a role in the dual-use licensing process, with each office reviewing specific types of commodities. The Office of Chemical, Biological and Missile Technology reviews missile, chemical, and biological commodities. The Office of Nuclear Energy Affairs is the advisor for nuclear energy related commodities. Finally, the Office of Export Control and Conventional Arms Nonproliferation Policy reviews a wide variety of areas including foreign national access to U.S. technology, machine and semiconductor tools, super computers, encryption equipment, and night vision goggles. The Bureau of Economic and Business Affairs, Office of Energy, Sanctions and Commodities also reviews licenses for crime control, foreign policy, economic, and human rights concerns.

Previous OIG work on Defense Trade Controls

In 1993, OIG conducted a joint review of the Government's export licensing processes with Inspectors General from Commerce, Energy, and Defense. The review found a fragmented process for dual-use licensing responsibilities within State. The review also found confusion at overseas posts over responsibilities for end-use checks and verifications, and a lack of program files and documentation.

State has made improvements subsequent to the 1993 review, including the consolidation of dual use export license processing under NP, and improved documentation of the referral process. In addition, Commerce's referral of dual-use license applications to State has improved. The 1993 report called for Commerce, in cooperation with Defense, Energy, and State, to provide a mechanism for resolving referral criteria disputes at progressively higher levels and periodically review referral criteria. During our current review, State cited no problems with dual-use referrals.

FINDINGS

State's export licensing process is working as intended. Based on a valid statistical sample, we found State was properly referring appropriate munitions applications to other agencies for review, and was fully addressing concerns that were raised. For the applications referred outside DTC, the final licensing decisions incorporated the provisos recommended by reviewing agencies.

Munitions License Applications

DTC refers munitions license applications to Defense, Energy, and to other bureaus within State for technical, national security, or foreign policy review. Applications that require technical expertise to review, such as encryption devices, computer source code, or technical data are referred to Defense, which receives the majority of DTC referrals. Energy reviews cases related to nuclear weapons and explosive devices. Applications dealing with intelligence issues are referred to the State's Bureau of Intelligence and Research, and applications to countries with human rights concerns are referred to the Bureau of Democracy, Human Rights and Labor. In FY 1998, DTC referred approximately 27 percent of its munitions license applications outside of DTC for review.

We reviewed a sample of 100 munitions license applications from the period January - June 1998, 25 of which were referred outside of DTC. The primary purpose of the review was to determine whether license applications for munitions were properly referred outside DTC. We also assessed the adequacy and accuracy of the supporting license documentation and the criteria that DTC licensing officers use when processing license applications. The following table illustrates DTC's license referrals over the last 4 years.

DTC Munitions License Referrals

Fiscal Year	Total # Applications Received	# of Applications Referred Outside DTC	% of Applications Referred Outside DTC
1995	46,020	11,710	25.4
1996	45,783	14,518	31.7
1997	45,844	14,200	30.9
1998	44,212	11,955	27.0

Based on our review, DTC is properly referring munitions applications to other agencies for comment, and we found no cases where licenses should have been referred but were not. Furthermore, in all applications referred outside DTC, the final licensing decisions fully incorporated the provisos recommended by reviewing agencies.

Dual-Use License Referrals

State is also responsible for making recommendations on dual-use license applications that have been referred from Commerce. In FY 1998, DTC reviewed 8,101, which is 75 percent of all dual-use license applications. We reviewed a sample of 60 dual-use license applications referred to State during the period January - June 1998. We met with each of the officials responsible for

responding to the referred applications and evaluated State's response to each application and the extent to which Commerce's final position incorporated State's recommendations.

We examined the procedures that State used to respond to the 60 dual-use license applications and found no discrepancies between the recommendations that State made and the final licensing decision reached by Commerce. However, we found that one office did not enter an official opinion within the 30-day time limit on 5 of 31 (16%) of the applications in our sample, forfeiting its right to make a recommendation on the application. In FY 1998, one office did not meet the time limit and forfeited its vote on 1,224 of 4,500 cases (27%). NP officials stated that each application had been reviewed and they consciously decided whether to enter a formal position; however, there was no documentation verifying this information. NP officials also said that a formal position was not always entered within the 30-day time limit due to staffing shortages, but that additional staff were assigned to work on dual-use applications as a result of the recent merger with the Arms Control and Disarmament Agency. We believe State should continue to monitor this area to ensure that timeliness issues are addressed.

End Use Monitoring

DTC has a variety of procedures to ensure compliance with the conditions placed on export licenses. One of the primary checks is the Blue Lantern program, established in 1990 to ensure that U.S.-origin defense exports are sent only to the country of ultimate destination, for the specific end use and by the specific end user stated on the export license. We found that DTC could improve the Blue Lantern program by placing more emphasis on the selection criteria used to initiate Blue Lantern checks, more carefully monitoring the status of Blue Lantern checks, and assisting posts with adequate technical expertise when needed.

Selection Criteria

Currently, DTC uses a quota-like system for generating Blue Lantern checks, requiring licensing and compliance officers to develop one Blue Lantern check a week. Selection of the cases or items to be checked is usually left to the discretion of the licensing and compliance officers. The purpose of this is to ensure that DTC meets its goal of conducting approximately 500 checks a year. In FY 1998, DTC initiated 418 Blue Lantern checks. DTC officials stated that to reach their goal, they would like to increase the number of checks by approximately 20 percent.

In our view, the quality of checks is more important than the quantity, and there is little evidence that completing more checks will improve the effectiveness of the Blue Lantern program. DTC Blue Lantern program statistics from FY 1994-98 indicate that fewer than 10 percent of all Blue Lantern cases resulted in an unfavorable response, and that 26 percent were not responded to at all.

Overseas posts commented that DTC's criteria for initiating Blue Lantern requests were unclear. Posts also commented that some requests appeared to be insignificant both in terms of material and dollar value. DTC officials, for their part, contend that it is not practical to limit Blue Lantern requests to specified dollar levels because all Blue Lantern requests have some value. Although we agree that dollar value should not be the only factor in deciding to perform a check, we believe it should be considered when weighing the costs and benefits of initiating a check.

During our overseas fieldwork, we identified examples of Blue Lantern checks that appeared to be of minimal value:

- DTC requested one embassy to ascertain whether the host government's navy had ordered four common UHF radio antennas valued at approximately $650 each. However, according to embassy personnel, these particular antennas, unlike more sophisticated aircraft antennas, are easily obtained on the local commercial market.

- DTC requested another embassy to make appropriate inquiries into the bona fides of an application for spare parts for the host country air force. The parts were for F-4 and F-5 aircraft, which the host country military is known to have in its inventory. The parts had a total value of $3,924 and were described in the request as follows: 1- line, 1- oil inlet tube, 8- packing, 22 - packing, 9 - washer, 6 - field kit. The cable sent to post did not specify why this check was being initiated or its importance. An embassy official stated that it was unclear why these generic, inexpensive components for aircraft known to be part of the host country military would warrant a Blue Lantern check. The official stated that this check was not in the U.S. Government's best interest because if the post asks the host country military to research too many checks perceived as insignificant, the more important ones might not be taken as seriously.

- DTC requested another embassy to verify the bona fides of an application for approximately 300,000 steel bushings to be used as parts for the track shoe assembly of M113 armored personnel carriers, which are widely used around the world to transport people and supplies. The steel bushings cost approximately $.55 each and are widely available on the local market.

Given the limited number of Blue Lantern checks conducted each year -- 418 checks out of over 44,000 licenses in FY 1998 -- DTC should concentrate its attention on the most significant munitions categories. Factors that could be considered when initiating Blue Lantern checks include cases where (1) the commodity will contribute to the development of weapons of mass destruction or significantly enhance the capability of a military, (2) there is a high risk of diversion, (3) the commodity/technology cannot easily be obtained within the country, and (4) the dollar value of the license is high enough that the potential benefits will exceed the costs to conduct the check. This is especially important given the posts' limited resources.

Inadequate Monitoring

DTC is not consistently monitoring and following up on the Blue Lantern requests that it tasks the posts to complete. For example, at two of the five posts we visited, little attention was given to the Blue Lantern program until the posts became aware of our visit. At one of the posts, there were five Blue Lantern checks that had not been addressed in almost a year, and there were several Blue Lantern checks at another post that had not been answered in over 4 months. In addition, one of the posts had not had a designated Blue Lantern official for over 6 months.

DTC should strengthen the procedures to ensure that Blue Lantern checks are completed in a timely manner. Procedures in place include periodic monitoring by a designated Blue Lantern coordinator and weekly meetings on Blue Lantern cases involving licensing and compliance

personnel. Compliance officers are responsible for monitoring timeliness, but each officer does it differently with insufficient oversight from DTC managers. One compliance officer characterized the monitoring as "the honor system," meaning it is up to the individual compliance officer to follow up with posts on unanswered checks. Another officer stated that it was not possible to closely monitor the status of the Blue Lantern checks because of time constraints. Furthermore, DTC managers do not receive any formal reports that indicate how long a case has been open. The consequence of not closely monitoring Blue Lantern checks, coupled with delays by posts in completing them, is that some checks remain open for excessive periods of time. For pre-license checks, which comprise 70 percent of the cases, this ultimately results in licenses taking longer to be issued. DTC's records showed approximately 153 Blue Lantern cases that were still in progress as of January 7, 1999. Twenty-six of these cases had been open for over one year; three were initiated in 1995.

Technical Expertise

DTC needs to assist posts with the necessary technical expertise to conduct end-use checks that require on-site inspections of technical commodities. Although DTC requires very few technical on-site checks, our participation with DTC personnel in one such inspection revealed that technical expertise is key to ensuring that a check will have its intended impact.

In November 1998, DTC performed an on-site inspection of a joint U.S./Israeli missile program to verify the end use of eight items licensed through State's munitions process. DTC participated in this inspection because Embassy Tel Aviv did not believe it had the necessary expertise to inspect various chemicals and components related to the missile program. DTC did not agree that an in-depth inspection was needed because the items could be verified through document and serial number examination.

During the inspection, it was clear that DTC and embassy personnel lacked the technical knowledge about the items that were inspected. As a result, the inspection lacked credibility and would not deter potential diversions. The lack of technical expertise may have even produced the opposite effect because it illustrated how little the inspectors knew about the subject. Although some of the items had serial numbers that could be easily identified, it is unrealistic for someone to verify the authenticity of one of these components if they have never seen one before and don't understand its purpose.

DTC officials disagreed with the need to place more emphasis on the selection criteria for end use checks, and believe that the checks noted in OIG's report were valid and yielded valuable information. DTC officials also stated that they are not in a position to furnish posts with specialized technical expertise.

Training for Licensing Officers

State does not have a formal training program for either munitions or dual-use license processing. For dual-use applications, we found no significant problems related to training or guidance. State's role is advisory in nature, and the officials responsible for reviewing licenses have extensive backgrounds in export licensing. The absence of training on the munitions side is

potentially more significant because DTC licensing officers have greater responsibility and make the final decision to approve a license.

DTC relies primarily on an apprenticeship program to train new munitions licensing officers. This consists of about 4 to 6 months in which junior officers work closely with more experienced staff to learn the fundamentals of the munitions licensing process and develop skills in specific munitions commodities. This apprenticeship training results in officers who are recognized as experts by U.S. courts, where they often testify. However, given the high turnover rate, it is important that DTC develop new approaches to training. In FY 1998, DTC lost 25 percent of its experienced munitions licensing officers. It will take at least 3 years of on the job experience to fully train the replacements.

Training for more experienced licensing officers is limited. DTC tries to arrange for in-house briefings from other agencies and bureaus within State to keep licensing officers updated on intelligence issues. However, there is very little opportunity for the licensing officers to receive training outside the office.

DTC should improve training and enhance resource materials for licensing officers. This should include developing an in-house training program for new licensing officers, creating a handbook that provides an overview of the munitions licensing process, and updating the country handbook that summarizes basic foreign policy issues related to individual countries. Although DTC agrees that these recommendations are desirable, they stated that resources are inadequate to implement these changes.

Cumulative Effect of Technology Transfers

There is no straightforward, comprehensive evaluation of the cumulative effect of technology transfers resulting from the export of munitions items. Information on the cumulative effect of individual munitions license applications is obtained from a variety of processes. However, DTC indirectly assesses this area of export licensing through: (1) licensing officer review of each application to establish whether the items are in the military inventory of the intended recipient, (2) the referral process, (3) managerial review of countries of concern, and (4) trend analyses.

Nevertheless, DTC represents only part of a much larger picture. To fully evaluate the cumulative effect of an application, other factors, such as the impact of foreign military sales, knowledge of what other countries are exporting, and the internal capabilities of a specific country would need to be evaluated. A comprehensive assessment would probably require a joint effort with resources and coordination from all Federal agencies involved in the licensing process. In addition, as stated in the interagency report, such an effort would probably require congressional direction.

Inadequate Resources

Inadequate resources have made it increasingly difficult for DTC to meet its mandate, which has broadened over the last 2 years. This has caused numerous problems within DTC including increased workloads for licensing officers and substantial delays in the license review

process. Since the 1993 joint OIG review, DTC's average processing time for nonreferred munitions applications has more than quadrupled, and the processing time for referred cases has more than doubled. The increased workload for licensing officers has also contributed to employee turnover as more senior staff accept higher graded and less demanding positions at other agencies and in private industry. State gave DTC an increase of $2 million as of June 7, 1999. DTC plans to use the funds to add 23 new positions to its staff.

Increased Workload and Processing Times

During FY 1998, 16 licensing officers processed over 44,000 munitions licenses. In contrast, during the 1993 joint review, there were 22 licensing officers responsible for processing approximately 49,500 munitions licenses. This represents a 22 percent increase in the licensing officers' workload. Although the total volume of licenses has decreased, the number of more complicated, labor intensive cases have increased significantly. For example, technical and manufacturing agreements have increased by 88 percent, from 1,739 in 1992 to 3,278 in 1998. In addition, congressional notification cases have more than tripled since 1992 from 40 to 150.

The increased workload for licensing officers has resulted in longer processing times for cases. The average processing time for nonreferred and referred cases were as follows for 1992 and 1998:

License Processing Time at DTC

Fiscal Year	Average Processing Time for NONREFERRED cases	Average Processing Time for REFERRED cases
1992	4.5 days	38 days
1998	21 days	86 days

The increased processing time negatively affects U.S. businesses, which are forced to wait longer for licenses. The longer processing times also increases the licensing officers' workloads because they receive additional inquiries from exporters regarding the status of a license.

DTC Staffing

In comparison to the other agencies involved in the export licensing process, DTC has fewer staff and lower pay grades. For example, DTC has the lowest journeyman grade level, yet it has the highest workload in the export licensing community. This impedes DTC from maintaining an experienced staff and is problematic because it typically takes about 3 years before a licensing officer is familiar with most aspects of the job. The following table presents a comparison of the workload and grade levels of the agencies involved in the export licensing process:

Workload of Export Licensing Agencies

Agency	# of Applications Received in FY98	# of Licensing or Reviewing Officials	Ratio of Licensing Officials to Licenses	Journeyman Grade Level of Licensing Officials
State (DTC)	44,212	16	1:2,763	GS-13
Commerce (BXA)	13,541[1]	47	1:288	GS-14
Defense (DTRA)	11,053	9	1:1,228	GS-14 and 15

Lower grade levels and increased workloads impede DTC from attracting and retaining personnel. In recent years, two of DTC's more senior licensing officers accepted GS-14 promotions at Defense. Licensing officers have also accepted higher graded positions in other bureaus within State. DTC management expects additional turnover because Defense and another office within the PM bureau currently have openings for higher graded licensing officials. Our review recommended that State develop a plan to rationalize the grade structure of licensing officers with other agencies involved in the export licensing process.

Commercial Satellite Launch Responsibility

DTC's difficulty in addressing its workload with current staffing levels will be magnified by a provision in the National Defense Authorization Act for FY 1999, which transferred the licensing of commercial satellite launches from Commerce to State. Not only will this increase the total volume of licenses that DTC must review, it will also require DTC to provide additional reporting to Congress.

Department Comments on OIG Recommendations

Our report contained 13 recommendations for improvements that we believe are needed in State's export licensing operations. State officials generally agreed with 11 recommendations, including those to strengthen supervisory review, expand training, improve database accuracy, and provide referral decisions to other agencies. They did not agree with two recommendations in our report pertaining to the selection criteria for end use checks, and furnishing posts with specialized technical expertise for such checks.

* * * *

This concludes my statement Mr. Chairman. I would be happy to answer any of your questions.

[1] This figure includes approximately 2,573 commodity classification requests. Each commodity classification request can include up to 5 line items. Exporters submit commodity classification requests to Commerce, which determines whether the commodities require a license or not.

STATEMENT OF GREGORY H. FRIEDMAN

INSPECTOR GENERAL

DEPARTMENT OF ENERGY

BEFORE THE

COMMITTEE ON GOVERNMENTAL AFFAIRS

UNITED STATES SENATE

Thursday, June 10, 1999

Resubmitted for Hearing on Wednesday, June 23, 1999

Mr. Chairman and members of the Committee, I am pleased to be here today to respond to your request to testify on the review conducted by the Office of Inspector General of the Department of Energy's (Energy's) export licensing process for dual-use and munitions commodities. Our review was part of an interagency effort involving the Inspectors General of the Departments of Commerce, Defense, Energy, State, and Treasury and the Central Intelligence Agency. The interagency review was initiated following receipt of an August 26, 1998, letter from the Chairman, requesting that the Inspectors General update and expand on a 1993 interagency report concerning the export licensing process for dual-use and munitions commodities.

I will address our findings relating to Energy's export license review process, the corrective actions taken by the Department based on our 1993 report, and our concerns with the "deemed export" licensing process.

AUTHORITIES GOVERNING EXPORT LICENSE PROCESS

Several laws, Executive Orders, and regulations control the export of certain commodities and technologies. The authorities include the Export Administration Act of 1979. The requirements of the Act, which expired in 1994, were continued by Executive Order 12924 under the authority of the International Emergency Economic Powers Act. Other implementing authorities include the Export Administration Regulations; and Executive Order 12981, which authorizes Energy to review any export license applications submitted to the Department of Commerce (Commerce). Executive Order 12981 also provides Energy the authority to enter into Delegations of Authority

with Commerce regarding certain applications that Energy does not need to review. In addition, Executive Order 12981 establishes the interagency dispute resolution process. The Arms Export Control Act authorizes the President to control the export and import of munitions on the U.S. Munitions List. Department of State (State) administers export controls on all munitions through the International Traffic in Arms Regulations, and consults with Energy on export license applications for certain munitions.

Certain commodities and technologies are designated as "dual-use," that is, commodities and technologies that have both civilian and military application. Some dual-use commodities are designated as "nuclear dual-use" -- items controlled for nuclear nonproliferation purposes. An example of a nuclear dual-use item is fiber and filamentary material, such as carbon fibers. Carbon fibers are used in the manufacture of tennis rackets, golf clubs and fishing poles. Carbon fibers are also used in the manufacture of centrifuges for uranium enrichment activities. In 1998, Energy received about 2,200 export license applications from Commerce, mostly involving dual-use commodities.

Another group of controlled commodities is designated as munitions, which are goods and technologies that have solely military uses. High explosives are an example of a munitions commodity. In 1997 and 1998, Energy received a total of 10 munitions cases from State.[1]

[1] Subsequent to the release of our report, we learned that an additional munitions application had been referred to Energy during 1998.

Based on our analysis of Energy's process for reviewing nuclear dual-use and munitions license applications, we determined that, for the most part, Energy's process appears adequate. However, we identified several concerns. These include:

- Lack of regulatory guidance for processing munitions cases referred to Energy by State.
- Inability of Energy to obtain complete information on the final disposition of export cases.
- Non-referral of some applications by Commerce under Energy's Delegations of Authority.

Further, our review identified indicators of possible problems with the export licensing process for deemed exports.

ENERGY EXPORT LICENSE REVIEW PROCESS

The Nuclear Transfer and Supplier Policy Division in the Office of Nonproliferation and National Security is responsible for the review of export license applications. Based on this review, Energy recommends to Commerce or State either approval or disapproval of the license application, or approval with certain conditions. Procedures for processing dual-use license applications submitted to Commerce are clearly articulated in relevant regulations. There is no equivalent process for reviewing munitions cases referred by State.

Sample of 60 Cases Referred By Commerce

As part of the interagency review, Commerce provided a statistically-based sample of 60 export license applications that it had referred to Energy in the first six months of 1998. We determined that all of the 60 cases in the sample were appropriately referred by Commerce. Executive Order 12981 requires that, within 30 days of receipt of a referral, Energy will provide Commerce with a recommendation either to approve or deny a license application. Of the 60 cases referred to Energy, only two did not meet the 30-day timeframe, but were processed within 33 days of the referral.

We did not attempt to determine the appropriateness of Energy's license application recommendations for the 60 cases referred by Commerce. Rather, our analysis of the 60 cases was designed to determine the completeness, accuracy, consistency, and security of the Energy database that supports Energy's export license review process. This analysis did not identify problems with the Energy database. Energy's database, which is the Proliferation Information Network System, or PINS, contains the required records concerning the factual and analytical bases for Energy's advice, recommendations and decisions on the 60 referred cases. Also, Energy has established detailed procedures to limit access to the Energy database and to protect the information contained in the database. In addition, the Energy database retains considerable information on each export case and, therefore, provides a reliable audit trail regarding Energy's processing of the case.

We found minor discrepancies between information in the Energy and Commerce databases. One data field in the Energy database did not contain all of the Commerce comments because the comments were "truncated" when electronically sent to Energy. We understand this problem has been corrected.

Consistent with the Chairman's request, we examined the adequacy of the training provided to Energy analysts, the adequacy of the interagency "escalation" process for appealing disputed recommendations, and whether the analysts were improperly pressured by their supervisors regarding their recommendations on license applications. We determined that the analysts are provided an adequate level of training. Also, the escalation process for resolving agency disagreements regarding approval or disapproval of specific license applications appears to be satisfactory. Finally, we found no evidence that Energy analysts are being pressured improperly by their superiors to issue or change specific recommendations on license applications.

Energy's process includes a review for proliferation concerns. Energy analysts have access to classified intelligence information on end-users and suppliers, and export case information on cases that were reviewed by Energy as far back as 1978. Energy analysts use this information to assess the proliferation potential of the destination country of the export.

60 Cases Not Referred By Commerce

In order to determine whether Commerce was appropriately referring cases to Energy, an analysis was conducted of an additional random sample of 60 cases provided by Commerce. These cases had not been previously referred to Energy.

Of the 60 cases that had not been referred to Energy, a Nuclear Transfer and Supplier Policy Division analyst concluded that one case should have been referred. He reached this conclusion based on the involvement of a nuclear end-user for the commodity. However, Commerce maintains that a license application was not required for the commodity and, therefore, it did not need to refer the case to Energy.

Delegations of Authority

Certain commodities controlled for nuclear proliferation purposes comprise the Nuclear Referral List. Some commodities on the Nuclear Referral List are not intended for nuclear end-use or a nuclear end-user. For these commodities, Energy has provided Commerce with Delegations of Authority, which allow Commerce to process these commodities without referring the cases to Energy.

Energy officials in the Nuclear Transfer and Supplier Division independently reviewed a sample of cases covered by the Delegations of Authority to Commerce. Approximately 1,000 to 1,500

cases per year are covered by these Delegations. Based on Energy's review of a sample of these cases, Energy officials determined that approximately one percent should have been referred, but were not. Energy officials plan to rescind the Delegations of Authority to Commerce and determine whether they should be continued.

Munitions Cases From State

The International Traffic in Arms Regulations, implemented by State, include the U. S. Munitions List which identifies munitions commodities that are subject to export controls. Examples of such munitions commodities of interest to Energy include items that could be used in the design, development, or fabrication of nuclear weapons or nuclear explosive devices. These regulations do not require State to refer license applications for munitions commodities to other agencies for review and there is no formalized system for escalating and resolving differences among agencies. As a result, Energy's role in reviewing munitions license applications is not clear.

Historically, State has received few requests for the export of nuclear-related commodities. However, when received, State will, as a matter of practice, refer munitions license applications for such commodities to Energy for review. Energy processes munitions license applications in the same manner as dual-use applications referred from Commerce. In addition to the cases referred to Energy during 1997 and 1998, State and Energy periodically consult to determine whether Energy should review other munitions license applications.

Corrective Actions Required By Other Agencies

Our review disclosed several issues that would best be addressed by other agencies or an interagency task force. For example, there is no process for interagency meetings on munitions cases or for escalation of disagreements over munitions cases. Also, Commerce officials were concerned that several agencies, including Energy, did not always send an Assistant Secretary-level representative to meetings of the Advisory Committee on Export Policy, which is responsible for resolving interagency concerns and differences over export license applications. The Advisory Committee is chaired by the Assistant Secretary of Commerce for Export Administration and has as its members Assistant Secretary-level or equivalent representatives of State, Defense, Energy, and the former Arms Control and Disarmament Agency. At Energy, an Assistant Secretary for Nonproliferation and National Security was recently appointed. We have been advised by the Department that the Assistant Secretary will attend Committee meetings involving extremely sensitive export cases.

In addition, the Commerce database was unable to electronically transmit large diagrams and other oversized documents that support export license applications. Thus, Energy must often either request from Commerce the required documents or contact the applicant directly. The current process used by Commerce to provide supporting documents to Energy might, therefore, adversely impact the timeliness of Energy's review process and should be improved.

1993 Report Recommendations

Our 1993 report on Energy's export licensing process contained 11 recommendations for corrective actions. Although we found that Energy had, for the most part, implemented the corrective actions within its control, several recommendations require additional review and action.

Five recommendations involved matters concerning records retention and the need to document the factual and analytical bases for Energy's recommendations to Commerce on export cases. These recommendations were resolved as a result of the implementation of PINS. A sixth recommendation was addressed by the development of new procedural manuals for use by Energy's export control analysts when processing export cases.

Of the five remaining recommendations, two still require corrective action by Energy. An assessment is required by Energy of the adequacy of the staffing level for the Nuclear Transfer and Supplier Policy Division. This Division has assumed additional responsibilities and may not be adequately staffed. Also, actions are required by Energy to ensure that the Department's intelligence capabilities are being fully utilized in the processing of export cases. Although Energy analysts were generally satisfied with the level of support provided by Energy's Office of Intelligence, one analyst was concerned that intelligence analysts were only providing abstracts of intelligence data and not the actual "raw data."

The remaining three recommendations in our 1993 report will require interagency coordination to assure appropriate implementation of corrective actions. Two recommendations require Energy to coordinate with Commerce to obtain information regarding the shipment of commodities. Although Commerce provides Energy information regarding whether a license application was approved or disapproved, Commerce does not inform Energy whether the commodity was actually shipped. The remaining recommendation requires Energy to coordinate with State to obtain information regarding whether a license application was approved by State for a munitions commodity and whether the commodity was actually shipped. This type of information from both Commerce and State would assist Energy analysts in their review of license applications for possible proliferation concerns.

"Deemed Export" License Process

During our review, there were indicators that Energy laboratories were not seeking export licenses for foreign nationals having access to unclassified information. According to the Export Administration Regulations, any release to a foreign national of technology or software that is subject to those regulations is "deemed to be an export" to the home country of the foreign national. We reviewed the export license process to determine whether hosts should have acquired deemed export licenses for foreign nationals having access to unclassified information or technology.

Our sample included foreign national assignees from China, India, Iran, Iraq, and Russia, who were involved for more than 30 days in unclassified activities at four Energy laboratories: Lawrence Livermore National Laboratory, Los Alamos National Laboratory, Oak Ridge National Laboratory, and Sandia National Laboratories.

We also looked at a sample of projects at the Energy laboratories in which these assignees had participated. The purpose of this sample was to determine whether there were any export concerns regarding the assignments.

During our visits to the four Energy laboratories, we found that guidance was not clear regarding when a deemed export license would be required for an assignment involving a foreign national. This apparently was largely due to the fact that the Export Administration Regulations, the relevant Energy order, and internal Energy guidelines did not clearly explain when a deemed export license may be required.

In addition, we found that the processes at the laboratories for reviewing assignments of foreign nationals generally rely on the hosts of the foreign national assignees to determine whether there are export concerns associated with the assignment. Hosts are required to be Energy or Energy contractor employees. We found several hosts who were not aware of, or did not understand, the requirements for deemed export licenses, and several hosts who did not appear to exercise appropriately their host responsibilities.

The following examples illustrate our concerns with the deemed export process.

- A security specialist at Los Alamos National Laboratory said that they rely on the host to determine if a deemed export license is required for a foreign national assignee. However, nine of the 14 hosts we interviewed contended they were not responsible for making this determination.

- At Oak Ridge National Laboratory, the form used for approval of assignments involving foreign nationals requires the host to indicate whether the assignment will result in the disclosure of technical data that may be subject to export controls. However, 13 of 17 hosts said that they were not responsible for this determination. Also, five of the hosts acknowledged that the foreign nationals they were hosting were affiliated with a nuclear facility or nuclear end-user in their home countries. The Energy analysts we consulted as part of our review, informed us that at least two export licenses might have been required for the assignees because of their nuclear affiliation. In addition, one scientist, who was the host of record, said that although he was listed as the host for a Chinese foreign national assignee, another Chinese foreign national assignee was the actual host.

Our review also disclosed that there is no organization within Energy that has management responsibility for the deemed export license process. Although the Nuclear Transfer and Supplier Policy Division has some responsibilities for reviewing deemed export license applications, that office was not providing oversight of the deemed export process. Energy officials, in response to

our report, stated that the Department is establishing a new policy that will clarify where responsibility lies between Headquarters and DOE facilities.

We selected a relatively small, judgmental sample of the documentation processed for proposed assignments to the laboratories of foreign nationals from the five countries included in our review. From this sample, we identified several cases where an export license may have been required because of the information being accessed or the individual's employer. For example, at Oak Ridge National Laboratory, a license application might have been required for three of 20 foreign national assignees because of possible access to technology subject to export controls. A license application may also have been required for two other assignees because of their affiliation with nuclear end-users in their native countries. Also, at Lawrence Livermore National Laboratory, one foreign national assignee was involved in discussions about lasers, which might have exposed the individual to export controlled technology.

On March 16, 1999, we advised the Acting Deputy Secretary of our concerns regarding deemed exports. We subsequently met with Energy officials regarding our preliminary findings. Following those meetings, Energy officials initiated a number of corrective actions that address the recommendations in our report. Among the more significant actions are:

- establishment by the Under Secretary of an export control task force to review export control issues relating to Energy facilities, including deemed exports;

- initiation of dialogue with Commerce on the issue of deemed exports;

- redrafting of policy with respect to unclassified foreign visits;

- redrafting of export control guidelines that would clarify requirements for deemed exports;

- initiation of efforts to educate Energy personnel on the issue of export control.

Summary of Review

In summary, we found that, with the exceptions that I have previously discussed, Energy's export licensing process for dual-use and munitions commodities was adequate. We also found that additional actions are needed by Energy to complete the recommendations in our 1993 report. Some of these actions will require coordination with Commerce and State. Finally, we found that clarification and improvements are needed in Energy's process for determining whether an export license is required in conjunction with assignments of foreign nationals to Energy laboratories. Management agreed with the recommendations in our report and identified specific actions to implement each of the recommendations. We intend to closely monitor Energy's actions.

Mr. Chairman, this concludes my testimony. I would be pleased to answer any questions.

Testimony Before the
Committee on Governmental Affairs
United States Senate

June 23, 1999

Interagency Review of Dual-Use and Munitions Export Licensing Processes

Statement by Lawrence W. Rogers
Acting Inspector General

Department of the Treasury
Office of Inspector General

Mr. Chairman, Members of the Committee, I am pleased to appear before you today to discuss the role of the United States Customs Service (Customs) in export license control. The Office of Inspector General of the Department of the Treasury recently participated in the Interagency Review of Export Licensing Procedures. This was a multiple agency review of export license controls performed at the request of this Committee, which included the Departments of Commerce, Defense, Energy, State, Treasury and the Central Intelligence Agency.

The Committee requested the six Inspectors General (IG) to update a 1993 special interagency review of the export licensing process and to answer 14 questions. It should be noted that the Treasury IG did not participate in the 1993 review. Most of the questions focused on the license review and approval process and end-use checks. One question, however, dealt with assessing the procedures used to ensure compliance with conditions placed on export licenses. While this question was primarily concerned with issues such as retransfers without U.S. consent, replications and peaceful use assurances, our review expanded this area to include Customs' role as the last check point to ensure that what was shipped is what was

approved, and to prevent any attempts to ship munitions and dual-use items without a properly approved license.

One method Customs uses to carry out this enforcement role is through an operation known as EXODUS. Operation EXODUS is an intensified enforcement program established in 1981 to intercept illegal exportations of munitions, strategic technology, and shipments bound for sanctioned countries. Through this and other efforts, Customs seized nearly 1,800 shipments of illegal exportations of dual-use items and munitions during Fiscal Year (FY) 1998. Investigative efforts resulted in hundreds of arrests, indictments, and convictions.

Despite these results, there are vulnerabilities which could lead to unlicensed shipments of munitions and dual-use items or licensed shipments that do not comply with the terms and conditions of the license. In our report, we made 11 recommendations to Customs for actions it should take within its own organization and in coordination with the Departments of Commerce and State, to strengthen enforcement operations and reduce the vulnerabilities. Due to the sensitive nature of the weaknesses we identified, I cannot provide specific information to describe all of them

in this open hearing. However, we have made our full report available to the Committee, and I will briefly summarize our findings for you in this statement.

Our report contains four major findings:

1. Untimely export reporting data constrain targeting efforts;
2. Customs' export license enforcement efforts need strengthening;
3. Enforcement of Department of Commerce licenses is hindered; and
4. Departments of Commerce and State license applications were not routinely screened against the Treasury Enforcement Communication System (TECS) database.

With regard to the first finding, we found that Customs' ability to effectively target unlicensed export shipments is constrained by current law applicable to the Department of Commerce's Bureau of Census and Bureau of Export Administration regulations. Due to the law enforcement sensitivity of this issue, I cannot provide more detail in this hearing. However, this issue poses significant risk since unlicensed exports comprise about 95 percent of the

approximately 20 million export transactions that occurred during FY 1998.

With regard to the second finding, our audit identified other areas not constrained by law or regulation where Customs' enforcement effectiveness can be improved. For example, most EXODUS team members we surveyed were unaware of the availability of Commerce licensing data in the TECS database. Access to such data is necessary to assist in cargo clearance and enforcement procedures because the only license information available to Customs Inspectors on export reporting documents is the license number itself. More access to this data, as well as increased awareness of its existence and usefulness, needs to be provided to Customs inspectors.

Our audit also identified that there may be a need to increase Outbound enforcement staffing levels at land border ports. Failure to provide continuous coverage for all outbound traffic results in some shipments being exported without review or inspection. Also, operation EXODUS enforcement efforts can be strengthened by reducing the frequency with which inspectors assigned to EXODUS teams rotate, and by developing a national EXODUS training

program. Some EXODUS teams have experienced a turnover rate as high as 50 percent. Coupled with the fact that EXODUS team members receive very little specific training, this can result in staffing EXODUS teams with high levels of inexperienced personnel, thereby reducing enforcement effectiveness.

Another area of vulnerability identified by our review involves controls over foreign military sales exports. While I cannot describe the specifics surrounding this control weakness, it has the potential of allowing exports of foreign military sales shipments that are in excess of licensed amounts. Finally, in carrying out their enforcement efforts, Customs inspectors, when necessary, will make license determination queries to the Departments of Commerce and State. We found that this is a manual process which is inefficient and contributes to internal processing delays. We recommended that Customs determine the feasibility of automating this process.

Regarding our third finding, we found that enforcement of Department of Commerce licenses is more difficult for Customs than licenses granted by the Department of State. Two weaknesses contribute to this. First, Commerce

regulations and licensing procedures do not require control, tracking, and closure similar to those required for State licenses. As a result, Customs is unable to ensure that authorized export amounts are not exceeded on Commerce licenses. Second, Commerce does not always respond to Customs' license queries in a timely manner. Responses to queries we sampled took an average of 24 days. This can cause Customs to detain shipments for extended periods, unnecessarily interrupting the flow of trade.

Finally, with regard to our fourth finding, we found that license applicants and related parties were not always screened against the TECS law enforcement database. Neither Commerce nor State were routinely referring applications, including related parties to the transaction, to Customs. This increases the potential that licenses could be granted to exporters or their affiliates who have derogatory backgrounds. While primary responsibility for referring applicant data for screening against TECS rests with the licensing agencies, Customs has a role to play with the support it provides for this process. We believe resource requirements are a major reason why the screening of all applicant data is not being conducted. The IG at Commerce also reported this issue. We recommended that

Customs work with Commerce and State officials to review the adequacy of license screening support.

In conclusion, the interagency review has identified a number of weaknesses in the munitions and dual-use license application review, approval, and end-use check process. Numerous recommendations have been made to improve the licensing process. However, enforcement of the license provisions is equally important, and unlicensed exports can also pose a significant risk. Our review has identified some vulnerabilities in these areas that need to addressed as well. Customs has agreed to take action on all of our recommendations and to coordinate its efforts, where appropriate, with the licensing agencies. This concludes my remarks. I will be happy to answer any questions you or other Members of the Committee may have.

STATEMENT OF L. BRITT SNIDER
INSPECTOR GENERAL
CENTRAL INTELLIGENCE AGENCY

Before the
Senate Governmental Affairs Committee

on

CENTRAL INTELLIGENCE AGENCY SUPPORT TO EXPORT LICENSING PROCESSES FOR DUAL-USE COMMODITIES AND MUNITIONS

Thank you very much, Mr. Chairman. I am pleased to have this opportunity to speak with you about the Central Intelligence Agency's role in supporting the export licensing processes for dual-use commodities and munitions. Along with the reports of the five other inspectors general responding to your call for a consolidated review, I have submitted a detailed report that presents the results of my review of the Agency's performance in the licensing processes. My report contains descriptions of certain analytical methodologies applied by the Agency and is therefore classified in conformance with national security guidelines. I can, however, summarize the findings of my review in this open hearing.

The Central Intelligence Agency directly supports the export licensing processes of the Departments of Commerce and State for dual-use commodities and munitions by providing relevant intelligence information that is available within the Agency on the end users and intermediaries identified in export license applications. The CIA obtains this information in the normal conduct of intelligence collection and analysis concerning proliferation activity and programs for developing weapons of mass destruction. The Agency provides additional support to the licensing processes by preparing finished intelligence reports and briefings on the results of these collection and analysis efforts, and through the participation of certain of its scientific experts and licensing analysts in the deliberations of the licensing advisory committees of the Missile Technology Export Control Group, Subgroup on Nuclear Export Coordination, and a chemical and biological weapons group.

One can debate whether the scope of the Agency's support to the licensing processes is sufficient, or whether CIA as an institution should do more. We evaluated CIA's performance against what it has committed to do in support of the Commerce and State processes, and, while we identified deficiencies in that performance, our overall conclusion was that the Agency was

substantially doing what it had undertaken to do. The resources devoted to providing this support, however, have not increased at the same proportion as the number of cases the Agency has been asked to review over the last three years, and, if the Agency should assume a larger role, clearly additional resources would have to be allocated from other missions. Ultimately it's a matter to be considered and resolved by the Agency and the two Departments we support.

What we attempted to do is look for weaknesses in the way the CIA currently supports the licensing processes at State and Commerce, and look for ways to improve that support. While the rationale which underlies our recommendations is classified – and the Committee has been provided a copy of our classified report – I am able to explain in general terms the nature of our recommendations without getting into classified information.

First, we found that not all of the Agency data bases that might reasonably be expected to contain relevant information on end users were routinely being searched by the analysts doing such searches. We recommended this be corrected.

Second, we found that the searches undertaken by CIA analysts were not being documented in a uniform way, either in terms of

recording what was done as part of the search or in documenting what was reported to Commerce or State. We recommended this be corrected.

Third, we believe that the response time of nine days which CIA has to review cases from the Department of Commerce is unrealistic and cannot be satisfied with the existing staff resources. We recommend that the Agency work with Commerce to establish a more realistic response time, and then staff its analytical capability accordingly.

Fourth, we found that Commerce does not fully appreciate the nature and limitations of the Agency's capabilities to support the licensing processes, and, in turn, Agency analysts do not always have a clear perception of the licensing officers' needs. We recommend a full-time Agency liaison officer be assigned to Commerce to help bridge this gap.

Finally, we saw a need for guidance to those in the Agency who are involved in the licensing processes that addresses management's expectations of the level of effort to be devoted to these efforts and that provides for alternative reporting channels in those instances when sensitive intelligence information cannot be included in routine end-user reports. We recommended that the

Special Assistant to the DCI for Nonproliferation formulate this guidance.

In sum, while the CIA plays a limited, supporting role in the export licensing processes, we believe it can play that role more effectively and efficiently than it currently does.

Thank you, Mr. Chairman.

Information Submitted by Senator Akaka:

DUAL-USE LICENSE PROCESS

U.S. exporters and foreign re-exporters are responsible for determining if they need a license to export or reexport items (commodities, software and technology) that are "subject" to BXA's Export Administration Regulations (EAR). In addition, certain activities of U.S. and foreign persons are subject to the EAR and would also require a license. For example, a U.S. person is prohibited from any involvement in the proliferation of chemical, biological or missile related activities and U.S. and foreign persons are prohibited from selling certain items subject to the EAR to sanctioned entities or to individuals and companies listed on the Denied Parties List.

The EAR establishes the scope of dual-use export controls and describes the policies, procedures and prohibitions associated with exporting or reexporting items "subject to the EAR." Items not subject to the EAR include: 1) items regulated by another U.S. Government agency (e.g., Departments of State or Energy); 2) publicly available information (e.g., books, sheet music, newspapers); and 3) publicly available technology and software (except software incorporating any encryption).

The EAR includes the Commerce Control List (CCL) which is a "positive list" that identifies items that require a license. Items on the CCL are identified by an Export Control Classification Number (ECCN). An ECCN identifies the technical control parameters and the reason for which an item is controlled (e.g., national security, missile technology). Items that are not listed on the CCL but which are subject to the EAR are classified as "EAR99." EAR99 items may require a license for export or reexport to: 1) terrorist and embargoed countries; 2) end-users or uses involved in proliferation activities (possible chemical, biological, nuclear or missile related activities -- EPCI – Enhanced Proliferation Control Initiative); or 3) sanctioned entities.

If an exporter is unable to determine the classification or the ECCN of its item, BXA will provide a commodity classification including whether or not a license is required or is likely to be granted for a particular transaction. Upon receipt of a classification request, BXA enters it into the Commodity Classification Automated Tracking System (CCATS) and transfers the case to an engineer for classification. Under the Export Administration Act, BXA has 10 days to process a commodity classification request.

Once an exporter has determined that a license is required, they should determine if a license is required for export to the country in question or if a "License Exception" exists which would authorize the export of the item without a license. There are 14 published License Exceptions which authorize the export or reexport, under stated conditions, of items subject to the EAR that would otherwise require a license. For example, certain items are eligible for export under License Exception LVS (Limited Value Shipment) if the value of the shipment is less than a certain dollar amount or certain computers which operate between certain performance threshold can be exported to civil end-users in certain countries. If no License Exception exists, the exporter must submit a license application to BXA.

Upon receipt of a license application, BXA personnel enter it into the Export Control Automated Support System (ECASS). Applications may also be received electronically. ECASS automatically transfers the application to the appropriate licensing branch and licensing officer (LO) for action. There are three licensing offices organized by technical function or CCL "reason for control" as follows: 1) Chemical/Biological; 2) National Security/Foreign Policy/Encryption; and 3) Nuclear/Missile. Simultaneously, the application is referred to BXA's Office of Export Enforcement where all of the parties listed on the application are screened against the Watch List for past violations, current investigations, proliferation concerns, sanctioned entities, etc.

> *NOTE: Section 12(c) of the Export Administration Act (EAA), protects company proprietary information from being published or released unless the Secretary of Commerce determines that withholding the information is contrary to the national interest. Proprietary information is contained in license applications and includes the applicant's name and address and the end-user's name and address. Section 12(c) states that this proprietary information can be released to Congressional Committees with jurisdiction over the EAA and Agencies involved n the license process.*

Within nine (9) days of receipt of a license application, the LO must obtain any necessary additional information, craft a technical and policy analysis, determine to which agencies the application should be referred based on any Delegations of Authority (DOAs), and to make one of three recommendations on the application: 1) approve; 2) approve with conditions; or 3) deny. BXA refers 85 percent of licenses it receives to the other agencies. Fifteen percent of the cases are unilaterally acted upon by BXA under the DOAs. BXA also "returns without action" applications for insufficient information or for items which do not require a license.

> *NOTE: Executive Order 12981 (E.O.) of December 1995, established new licensing procedures whereby agencies involved in the export control process can review <u>any</u> license application; however most agencies have given Commerce DOA's for certain items or countries. The E.O. also established tighter processing times and a dispute resolution escalation process. A decision must be rendered on a license application within 90 days or it must be referred to the President for decision. See Attachment A for a detailed description of the license time frames and the dispute resolution process.*

Each agency (Defense, State and Energy (NSA and FBI for encryption cases)) has 30 days to review a license application and provide BXA it recommendation. Agencies perform a technical and policy analysis and intelligence end-user assessment based on its mission. For example, Energy reviews applications to determine if an item could be used in nuclear activities or the possibility of diversion to nuclear activities and Defense reviews applications for all reasons of control including national security, proliferation, foreign policy reasons such as antiterrorism and

crime control. Simultaneously, the Central Intelligence Agency's Nonproliferation Center (NPC) reviews application for end-user involvement in proliferation activities. NPC should complete is review and submit a "Trade Review" analysis to Commerce and the other agencies within nine days. NPC does not make a recommendation on a license application.

If an agency recommends denial of an application, it must cite both the statutory and regulatory basis for denial, consistent with the EAA and the EAR. However, if an agency fails to provide BXA with its recommendation within the 30-day time frame of the E.O. , it is deemed to agree with the decision of Commerce.

The BXA LO must escalate the denied application to the Operating Committee (OC) for resolution. The LO submits to the OC a background paper including the BXA analysis and recommendation and the dissenting agency's position. The OC distributes the application to all agencies for discussion at the weekly OC meeting.

Executive Order 12981 authorizes the OC Chair to independently decide applications, even though the Chair is a Commerce employee. The OC Chair is objective in her decisions and does not necessarily vote the Commerce position on an application, although the interagency believes she favors the Commerce position. The Chair's decisions are usually based on the interagency consensus (except E13020, which amends Executive Order 12981, requires a majority vote for certain cases such as commercial communications satellites and certain "hot-section" technologies for the development, production and overhaul of commercial aircraft engines).

At the OC weekly meeting, the OC Chair briefly summarizes each application and opens the floor to discussion for views, comments and recommendations from each agency. The Chair records the major themes of the discussion and each agency's recommendation on an application, and prepares an OC License Determination rendering her final decision on the application. The OC Chair usually decides a case based upon the consensus vote of the OC members. If any agency disagrees with the OC Chair decision, it has five (5) days to escalate the case to the next stage in the dispute resolution process, the ACEP (Advisory Committee on Export Policy). Most cases, however, are decided at the OC. See Attachment A for a detailed time line and description of dispute resolution process, including review by the EARB (Export Administration Review Board) and the President of the United States.

If an agency or the OC recommends denial of an application for national security or foreign policy reasons (including proliferation), or if any parties to the transaction are determined to be inappropriate to receive controlled U.S. items, Commerce sends an "Intent to Deny" letter to the applicant which outlines the reasons the U.S. Government intends to deny its license application and affords the applicant the opportunity to rebut the decision within a 30-day period. If the applicant rebuts the decision and the response merits consideration, the Licensing Officer refers the application back to the interagency process for reconsideration. If the applicant either does not rebut the Intent to Deny letter or the rebuttal does not adequately respond to the issues of concern to merit reconsideration, the application is denied. However, under the denial procedure outlined in the Export Administration Act, the applicant has 45 days in which to "appeal" the denial decision to the Under Secretary for the Bureau of Export Administration.

If an application is to be approved or approved with conditions, even if the application was decided upon at the OC or EARB level, the Commerce Licensing Officer: 1) updates the electronic computer system with any necessary comments ensuring there is an adequate audit trail; 2) forwards any paper documentation for imaging; and 3) prepares the export license including the appropriate conditions for official approval by his or her supervisor. All Commerce license applications, whether approved, denied or returned without action, are countersigned by management. This is a quality control mechanism to ensure adequate oversight and consistency in licensing decisions.

Attachment – Expedited License Review Time Frames under E.O. 12981, Including the Dispute Resolution Process Time

PROCESSING DEADLINES	ACTIONS TO BE COMPLETED	COMMENTS
Day 1	Commerce **registers license application** & transfers it to Licensing Officer (LO). Simultaneously, application is screened by Export Enforcement for X	Applications are received by paper or electronically *Commerce has 9 days to refer case.*
Day 9	LO must prepare a technical & policy analysis on the application and make a recommendation to approve, approve with conditions, or deny. LO electronically **refers application to interagency** as required under the E.O. and Delegations of Authority.	Agencies include: Defense, State, Energy, Justice/FBI (encryption cases only). The CIA performs an end-user review.
Day 19	Agencies must request any additional information necessary for them to make a decision	*Agencies have 10 days to request additional information from Commerce*
Day 29	CIA's NPC must provide its end-user report which provides any information on known proliferation activities or procurements of the end-user or other parties to the transaction.	*NPC has 9 days to complete its end-user review*
Day 39	Agencies must provide their recommendations to Commerce. Recommendations for denial must cite statutory & regulatory reasons.	Agencies have *30 days* to review.

Day 40	Commerce LO must refer disputed applications, in writing, to the **Operating Committee (OC)** for resolution. OC meetings are held weekly. 95% of disputed are resolved at the OC.	OC is the **first level of the escalation process**. Voting-agencies are represented at the working level. Non-voting agencies include the CIA/IC, Joint Chiefs of Staff, Other agencies as appropriate. OC Chair's makes final decision on an application. OC must render decision within *14 days.*.
Day 53	OC Chair must render her/his decision on application and issues a Licensing Determination. If an Agency disagree with OC Chair's decision, it must escalate application within five days.	
Day 58	Dissenting Agency must appeal OC Chair's decision, in writing, to the to the **Advisory Committee on Export Policy (ACEP).**	ACEP, the **2nd level of the dispute process,** is chaired by Commerce's Asst. Secretary (AS) for Export Administration & members include AS's from voting Agencies. ACEP must render decision within *11 days*.
Day 62	Agenda for ACEP is distributed	
Day 66	ACEP Meeting is held. Decisions are made by majority vote.	
Day 69	Notice of ACEP majority decision is issued.	
Day 74	Dissenting Agency must appeal ACEP's decision, in writing, to the **Export Administration Review Board (EARB)** within 5 days.	EARB is chaired by the Secretary of Commerce & includes Secretaries from voting agencies. EARB must render decision within *11 days.*
Day 79	Agenda for EARB Meeting is distributed.	
Day 85	EARB Meeting is held. Decisions are made by majority vote.	Within 5 days a dissenting agency must appeal EARB decision to the President.
Day 90	**The President will review and decide application.**	

UNITED STATES
POSTAL SERVICE

June 30, 1999

William A. Reinsch
Under Secretary for Export Administration
United States Department of Commerce
Herbert Clark Hoover Building, Room 3989
14th St. and Constitution Ave., N.W.
Washington, D.C. 20230

Dear Under Secretary Reinsch:

The Postal Service would like to express our views concerning the letter report of June 15, 1999, addressed to you, which was written by Acting Inspector General Johnnie E. Frazier, U.S. Department of Commerce, and submitted to the Chairman of the Senate Committee on Governmental Relations as part of the classified volume of the interagency report concerning the export licensing process for dual-use commodities and munitions.

The report recommended that the role of the Postal Service in the export enforcement process needs to be clarified. We would be happy to work with the Commerce Department and others so that there is a better understanding of mail security regulations, the Postal Inspection Service role in enforcement of these regulations, and the Postal Service's role in export control. In turn, we would like to gain a better understanding of current export administration enforcement concerns. We agree that a review of the interaction between mail security regulations and export control regulations would be prudent, especially given the sweeping changes in worldwide economic and political conditions, and in the climate for controlling the export of U.S. commodities and technology.

The Postal Inspection Service would be pleased to establish a liaison or working group with the Commerce Department's Office of Export Enforcement, and other interested agencies, to better coordinate on enforcement issues as they may apply to the mail. We believe there are a number of topics for fruitful discussion, including what types of exports or geographical areas may be of particular enforcement concern. This exchange of information would allow the creation of better profiles to improve Inspection Service investigations and its coordination with other enforcement agencies. Because enforcement concerns evolve or change, ongoing information sharing is critical.

We also believe that this discourse would enable the Postal Service to update regulations contained in the International Mail Manual, so that mailers and postmasters can more easily understand the mailing requirements and export

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Washington DC 20260

control requirements. We also agree that a public information effort to make people more aware of export restrictions applicable to the mail would be helpful to mailers.

We certainly wish to discuss with the Commerce Department Mr. Frazier's concern that outbound international mail could be used by those who wish to circumvent dual-use export controls, and his concern about Postal Service adherence to export control regulations. We look forward to discussing these issues in the near future and thank you for your consideration.

R. Andrew German

R. Andrew German
Managing Counsel
Legal Policy Section
Law Department

cc: Senator Fred Thompson, Chairman
Senate Committee on Governmental Affairs

Johnnie E. Frazier, Acting Inspector General,
United States Department of Commerce

Karla W. Corcoran, Inspector General
United States Postal Service

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